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CRIME AND SECRECY: THE USE OF OFFSHORE BANKS AND COMPANIES

REPORT

MADE BY THE

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OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

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Mr. ROTH, from the Committee on Governmental Affairs, submitted the following

REPORT

I. INTRODUCTION

In 1982, the Permanent Subcommittee on Investigations (PSI) began examining the criminal exploitation of offshore tax havens, through the use of banks, trusts, and companies. The subcommittee's review encompassed the full range of criminal activities, from those commonly associated with drug trafficking and commodities fraud, to the more unexpected use of offshore facilities by American tax protestors.

The subcommittee found that the criminal exploitation of offshore havens is flourishing because of haven secrecy and foreign government intransigence in the face of overwhelming evidence of dirty money in their banking systems. The effect has been to systematically obstruct U.S. law enforcement investigations, erode the public's confidence in our criminal justice system, and thwart the collection of massive amounts of tax revenues.

A 1983 Joint Economic Committee report estimated the U.S. underground economy hides $222 billion from the IRS—7.5% of the gross national product. Various other estimates peg the amount hidden anywhere from $150 billion to $600 billion. Without question, the underground economy is linked to the use of offshore facilities.

The illicit export of funds is estimated to account for $20 billion of this underground economy. According to the Income Tax Compliance Research, published in July, 1983, by the IRS Research Division, the so called "tax gap" (taxes owed as opposed to those actually received) has grown from $30.9 billion in 1973 to $90.5 billion in

1981. The document goes on to state that "declines in income tax compliance while persistent, have been only moderate". However, the report notes an important reservation: Indirect evidence indicates tax haven funds may have been increasing at "extraordinary rates" and these funds may well represent an unmeasurable addition to the tax gap. The report cites the 1981 IRS Study "Tax Havens and Their Use by U.S. Taxpayers" (the Gordon Report) noting that between 1968 and 1978, international deposits made by non-bank depositors in banks located in all important tax haven areas increased from $5.3 billion to $88.7 billion, an average growth rate of 33% per year. Since major U.S. fiscal, economic, and tax policy decisions are based in part on these tax gap estimates, and as the offshore variable—which could be huge—hides behind an impenetrable veil of secrecy, the significance of haven secrecy may well transcend the issue of criminality and thus have major economic policy ramifications for the United States. Though the subcommittee's review has touched briefly upon these issues, we have, of necessity concentrated on the purely criminal aspects of the use of offshore havens.

Offshore criminal activities involve many U.S. enforcement agencies: the Department of Justice, Federal Bureau of Investigation, Drug Enforcement Administration, Internal Revenue Service, Comptroller of the Currency, Customs Service, Postal Service, Securities and Exchange Commission, and the Commodity Futures Trading Commission. In addition, offshore crime tends to concern the U.S. Federal Reserve, the State Department and our military and intelligence agencies because it occurs in the context of domestic and foreign banking and political affairs.

In an April 19, 1984 letter from the Commissioner of IRS to Senators Roth and Nunn, the Commissioner clearly described the phenomenal growth of the use of haven secrecy laws to hide criminal income. His letter stated:

> Approximately 15 to 20 years ago, the majority of our criminal investigations involved alleged violations of a single taxpaying entity. Today, more of our investigations are centered around organized efforts to evade and defeat the payment of taxes. Tax evaders are becoming more sophisticated in their methods and techniques of committing these violations. We are now dealing with tax evasion on an international scale. The current trend is to use the secrecy laws of tax haven countries to facilitate tax evasion. For example during the period 1977 through August 1983, we identified 772 criminal cases which had financial transactions involving some 90 foreign countries. A conservative estimate of unreported income in these 772 cases exceeds $2.6 billion. The frequency of our cases involving foreign countries is increasing.

The Commissioner went on to state that the IRS has observed a rapid increase in organized criminal activity in three areas: (1) abusive tax shelters, (2) narcotics trafficking, and (3) illegal tax protesters. The Commissioner noted that these activities are not limited to any particular faction of the U.S. population.

This statement supports the findings of the subcommittee's investigation. As noted in the subcommittee's 1982 staff study, previous PSI testimony revealed the use of haven secrecy laws to hide the proceeds of home health operator fraud, commodities fraud scams, narcotics traffickers, organized crime operations, embezzlement from corporations, corporate kickback schemes, tax protesters, tax shelter schemes, and other illegal activities. When the subcommittee first undertook this investigation it fully expected to confirm the extensive use of the offshores by narcotics traffickers and organized crime. Somewhat surprising, however, was the revelation that such use is far more pervasive in American society and is continuing to grow at an alarming rate.

The subcommittee's investigation has been far reaching, and has already been used as support for the passage of several bills in the Senate. The subcommittee's staff study and hearing record of the March 15, 16 and May 24, 1983 hearings were utilized in the preparation of the Treasury Department's January 1984 study, "Tax Havens in the Caribbean Basin" and the President's Crime Commission's 1984 report on money laundering.

While the subcommittee's investigation concentrated on the criminal use of offshore facilities, an understanding of the much larger legitimate use of such facilities was considered critical. Hence, the staff interviewed many senior officers of multinational banks, attorneys specializing in international law and international taxation, bankers, attorneys, and senior government officials in several haven countries, senior financial officers and counsel for multi-national firms, and owners of offshore banks. International economic and financial considerations have also been discussed with officials of the International Monetary Fund, the Department of State, the Federal Reserve Board, the Treasury Department, the Eastern Caribbean Currency Authority, the Bank of England, central bank authorities from several haven countries and the Congressional Research Service.

Our study of the criminal use of offshore facilities took us to senior representatives of the major Federal, State and local law enforcement agencies in the United States, the Attorneys General of the haven countries visited, to INTERPOL, the British Commonwealth Secretariat and to persons convicted of crimes, the fruits of which were laundered through offshore facilities.

Subcommittee staff visited Antigua, the Bahamas, Bermuda, the Cayman Islands, Montserrat, St. Vincent, Barbados, Panama, and the Turks and Caicos. A consultant to the subcommittee visited Great Britain and Switzerland. The subcommittee staff also met with representatives of Canada, the Netherlands Antilles, Guam, and the Northern Marianas.

During its investigation, the subcommittee staff gained access to voluminous U.S. bank records which reflected offshore transactions. The results of these efforts are reflected in the hearing record. Staff also attempted to trace over $1 billion in currency repatriated through the U.S. Federal Reserve from Panama in 1983. The results of this effort are detailed in the Panama section of this Report.

Notwithstanding these efforts, the subcommittee obviously cannot reproduce the total body of knowledge and experience of all the experts in this field. This Report simply attempts to present the issues in a large enough context to demonstrate the enormous problems presented. The report has been prepared with the assistance of several present and former members of the staff and consultants included: Charles Morley, chief investigator; former staff investigators Karen Hainer and Joyce Papes; Professor Richard Blum (consultant); ex-IRS Agent William Jackson (consultant); Carolyn Kulisheck, staff researcher; Thomas McLaughlin, detailed Secret Service Agent; Daniel Mastromarco, staff counsel and the former chief counsel, S. Cass Weiland. The subcommittee has also had the benefit of an excellent support staff and the encouragement and suggestions of the minority staff.

II. OVERVIEW OF LAW ENFORCEMENT ISSUES

Senator Roth opened the subcommittee's hearings on the criminal uses of offshore banks and companies by noting:

> What we (PSI) have found during these 2 years is a problem that is pervasive and growing. It is also complex, because one of its main roots is a clear difference in philosophies. We disdain bank and corporate secrecy to the degree it is practiced elsewhere, whereas secrecy is exalted and protected in other countries—many of them our friends and allies. . . .
>
> During this investigation and others which the subcommittee has conducted we have repeatedly heard testimony about major narcotic traffickers and other criminals who use offshore institutions to launder their illgotten profits or to hide them from the Internal Revenue Service. Haven secrecy laws in an ever increasing number of cases prevent U.S. law enforcement officials from obtaining the evidence they need to convict U.S. criminals and recover illegal funds. It would appear that use of offshore haven secrecy laws is the glue that holds many U.S. criminal operations together.
>
> But equally shocking is the fact that we have also found that offshore havens are no longer used exclusively by criminals. Instead they are increasingly being used by otherwise law abiding Americans to avoid paying taxes and to shield assets from creditors.[1]

PSI hearings addressed such critical issues as: (1) the ease with which huge amounts of illegally derived wealth are secretly transported out of and into this country and elsewhere around the world; (2) the concealment afforded by bank and commerical secrecy and blocking laws of many offshore jurisdictions; (3) the difficulties encountered by U.S. law enforcement authorities in attempting to interdict criminal money outflows or to penetrate the offshore secrecy veil; (4) the brokering of offshore banks and companies to U.S. citizens and the use of such entities for unlawful purposes; and (5) the collision of U.S. governmental interests, policies, and practices with those of the "secrecy" countries—a collision from which the criminal more often than not escapes unscathed, his profits secure.

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[1] Hearings, p. 2.

No one really knows how much money is moved offshore each year, though it has been acknowledged that organized crime, narcotics traffickers, and other operators make regular use of tax havens. In these nations full legal and banking services can be found for a proper fee, a price which is willingly paid by those looking to move funds quickly and efficiently. Most of the havens have strict banking secrecy laws or policies, making it almost impossible to know who actually owns the funds. By providing anonymity for foreign money, and by refusing to cooperate with U.S. law enforcement, tax havens are being exploited by criminals. Today the use and abuse of offshore facilities is more sophisticated and difficult for investigators and prosecutors to unravel than ever before. Several recent examples are illustrative:

At PSI's hearing on March 16, 1983, it took 6 Customs agents 45 minutes to haul $3.6 million in small bills into the Senate hearing room. The exhibit, which weighed 700 pounds, was money seized from one laundering scheme, run by the Sonal Corporation in Colombia through the Capital Bank in Florida's North Bay Village. Beno Ghitis-Miller, the convicted money-exchanger whose family owned and operated Sonal, told the subcommittee:

> In 1978, when I took over . . . we were exchanging around $2 to $3 million dollars a month. By the middle of 1981, we were averaging $35 million a month.[2]

While Ghitis says he "verified" that the money he was exchanging did not come from illegal narcotics trafficking, Customs officials maintain, and the U.S. District court concurs, that at least $240 million was deposited at the Capital Bank—money that derived from drug purchases in the United States.[3] Couriers brought the bills to Capital Bank in cardboard boxes and paper bags to be deposited in an account for which Ghitis paid the bank a "service fee" of one-eighth of 1 percent of the total cash deposit each month. When the deposits soared to $1 million a day, the bank increased its fee on the Sonal account to $300,000 per month. Capital Bank, ironically, stayed within the law because currency reports from the bank were filed.

Marc Rich and his partners, running a large commodity-trading firm, were indicted in late 1983 on racketeering, fraud, and tax evasion charges. Focusing on Rich's oil dealings during 1980 and 1981, the government charges that Rich schemed to violate Federal oil price controls by using paper transactions involving various Texas companies. Prosecutors allege Rich laundered the oil through the companies so he could sell it at a higher price, and that he then laundered the profits from that scheme by having the Texas companies send the money to his Swiss headquarters.

In response to Rich's bids to prevent the government from gaining access to his offshore corporate documents and bank records, the Justice Department has won over $5 million in fines against Rich because he has not complied with a court order to produce documents. Additionally, Justice Department prosecutors physically intercepted two steamer trunks full of documents that Marc Rich was attempting to fly from New York to Switzerland. On October 15, 1984, the Marc Rich Co. pleaded guilty to criminal tax charges and agreed to pay $150,000,000 in back taxes to the Federal Government.[4]

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[2] Hearings, p. 76.

[3] See testimony of U.S. Customs Service Commissioner von Raab, Hearings, p. 61, et seq.

In the same month as the Marc Rich indictment, two General Dynamics shipbuilding executives were indicted for accepting over $2.7 million in kickbacks, which was then transferred to numbered Swiss bank accounts through the use of Cayman Island companies. Although both General Dynamics executives failed to show up for their arraignments, a co-defendant, who was an executive with the subcontractor, Frigitemp Corporation, was convicted in 1984. Meanwhile, one of the General Dynamic officials, who fled to Greece, had sought a deal in exchange for information allegedly implicating other company officials.[5]

Even major international banks are not immune from questionable, hidden transactions. In 1980, the Nugan Hand Bank based in Sydney, Australia, with 22 offices around the world (including four in the U.S.), went into liquidation with $50 million unaccounted for—$20 million of it missing from its branch in the Caymans, where the bank was originally registered. Evidence has surfaced indicating that the Nugan Hand Bank was deeply involved in moving funds for international heroin dealers and may have been involved in international arms trafficking. Moreover, suspicions have been raised that Nugan Hand may have been used to channel funds to favored Australian political candidates. About 10 weeks before the Nugan Hand Bank failed, Frank Nugan, director of the bank, was found shot to death—an apparent suicide—in his Mercedes-Benz in a woods near Sydney.[6]

In 1982, Banco Ambrosiano of Milan, Italy collapsed, crippled by the exposure of $1.4 billion in loans which were made to several mysterious Panamanian "shell" companies which had been endorsed by the Vatican Bank, Istituto per le Opere di Religione. Banco Ambrosiano, the largest private banking group in Italy, had operations in 15 countries. Frank Sindona, now serving a 25-year prison term in upstate New York for bank fraud in connection with the 1974 collapse of Long Island's Franklin National Bank, says he was involved with the Banco Ambrosiano president, Robert Calvi, and other members of the secret Italian Masonic lodge known as Propoganda Street, or P2, in sending Ambrosiano money to Latin America to support right-wing political causes. Seven weeks before Banco Ambrosiano collapsed, Calvi was found hanging from a rope on a workmen's scaffold beneath London's Blackfriars Bridge. In July of 1984, a Milan court convicted Sindona for fraudulent bankruptcy in the 1974 collapse of Banco Private Italiana in which the Vatican bank was a shareholder. Sindona will face a separate trial once extradition is granted by the United States.

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[4] This event was widely reported in the international media (See Washington Post article of Oct. 16, 1984; New York Times, Oct. 16, 1984.)

[5] Reference Washington Post article of December 25, 1983 re: P. Takis Veliotis.

[6] See "Fall of a Banking Firm Spotlights the Role of High U.S. Officials", by Jonathan Kwitney, The Wall Street Journal, August 24, 25, 26, 1982.

The secrecy surrounding such large-scale schemes as these is extremely difficult to penetrate and calls for extraordinary investigative and prosecutorial efforts. And the question arises, can law enforcement afford to invest such energies routinely? What if the affairs listed above are only the tip of the iceberg? What if the average American, a Midwestern farmer for example, is laundering several hundred thousand dollars a year in receipts through obscure banks located in the Pacific and Caribbean? Unfortunately, many average Americans are, in fact, secretly taking their money offshore.

PSI'S INVESTIGATION—MID-AMERICA GOES OFFSHORE

A part of the subcommittee's inquiry focused on the Oxford Bank and Trust Co. Ltd., in the Turks and Caicos Islands, BWI. The Oxford Bank originally came to the subcommittee's attention in 1981 during an investigation of international narcotics trafficking. On February 3, 1982, the subcommittee issued a subpoena to the Southeast Bank, N.A., of Miami, Florida, which acted as a U.S. correspondent for Oxford. The subcommittee received a limited sampling of photcopies of canceled checks, bank statements, items deposited and records of wire transfers of funds for the period of January 1, 1975 through December 31, 1981. The striking conclusion derived from this phase of the subcommittee's investigation is that offshore banking accounts are being used by people one might regard as "average American citizens." PSI's examination of records from this bank found that just 11 American account holders deposited more than $1 million over little more than a period of 1 year.

The records obtained from Oxford's correspondent bank, Southeast Bank, revealed a fascinating pattern of account activity for certain U.S. citizens. Essentially these account holders—individuals and businesses—were depositing what appeared to be gross income items or gross receipts into their accounts at the Oxford Bank. These same account holders were receiving large lump-sum checks from Oxford Bank.

Thomas McLaughlin, testifying for the subcommittee staff, explained PSI's findings at the March hearing:

> . . . The subcommittee staff observed an interesting pattern of deposit and withdrawal activity in many of the American account holders at the Oxford Bank. Directing your attention, Mr. Chairman, to the portion of the chart dealing with the R.S. and Vera D. Michel Trust account, we confirmed through investigation that Mr. Ray Michel was a principal in both Tiregon Leasing Co. and Interscience, Inc. The activity of this account provides a good example of how an offshore account might be used. The deposit total, as you can see, of over $472,000 was accomplished in seven transactions between June 1978 and August 1978. Beginning in October 1978 through March 1979, a total of $327,000 was received from the Oxford Bank in the form of checks payable to Tiregon Leasing and from Interscience, Inc. Although Mr. Michel refused to answer our questions regarding his Oxford Bank account,

> it is possible that moneys were being deposited into the trust account and then withdrawn in the form of payments to two corporations controlled by Mr. Michel.
>
> Directing your attention, Mr. Chairman, to the Nature Nook Trust account of Eldor and Ida Miller, although the deposit and withdrawal figures are not high, it is important to note that these figures represent 8 months of activity and involve over 400 separate transactions. The withdrawal figure of $21,703.29 was accomplished in just 12 transactions with the remainder of the transactions being deposits.
>
> Virtually all of the items negotiated at Oxford by the Nature Nook Trust were small third party checks from people in the United States. Since he refused to answer our questions, we can only speculate as to why Mr. Miller, a farmer from North Dakota, used an account at the Oxford Bank in the Turks and Cacios Islands. . .
>
> The subcommittee staff attempted to interview these Oxford Bank account holders to determine their reasons for maintaining an offshore bank account and most importantly, to solicit their cooperation in our investigation. After extreme effort, we succeeded in arranging only one personal interview. . . All other account holders either indicated their intent to plead the Fifth Amendment or avoided contact with the subcommittee.
>
> In written responses to our request for cooperation, and in rather restricted telephone interviews with these individuals, subcommittee staff members heard similar negative statements about the Internal Revenue Service and the U.S. banking industry. Several characterized the IRS as the "Gestapo" in the United States and most expressed distrust for the entire U.S. banking system. Some explained that their reason for banking offshore was to gain privacy of their financial affairs. And three expressed distaste for their offshore banking experiences. However, none would elaborate further.
>
> Our investigation of these 11 Oxford Bank account holders revealed the following. At least six of these individuals appear to be associated in some way with the agriculture industry. At least nine are, or have been, under IRS and/or grand jury investigation. Lowell Anderson was involved in some way with at least six other account holders.[7]

The subcommittee staff found that certain individuals, motivated by financial gain, exploit the anti-IRS biases of some of their fellow citizens and inflame their distrust of the U.S. Government, the banking industry and in particular the IRS. By promoting the secrecy and security aspects of offshore banking, these con men persuade susceptible individuals that they can legally avoid taxation by placing their assets in an offshore trust. For a few hundred dollars a trust is created in an obscure venue, like the Turks and Caicos Islands, and is then sold for several thousand dollars to an individual in the U.S. (The subcommittee has information that one trust cost the individual buyer up to $20,000.) A trust account is established with a bank, such as the Oxford Bank, to facilitate deposits and withdrawals from the trust.

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[7] Hearings, p. 103, et seq.

The promoters of these trust schemes emphasize that strict secrecy laws of the offshore country shield the identity of the trust owner and thereby insulate him and his assets from the Internal Revenue Service. If the individual has difficulties with the IRS, the con men continue their exploitation by advising how the IRS can be expected to proceed and how the taxpayer should respond. When the IRS proceeds exactly as advised, the trust owner's faith is reinforced.

That faith generally is not shaken by law enforcement's discovery of their financial activities; they seem committed to their ideological principles, as evidenced by their almost total lack of cooperation with PSI's investigation. Despite admissions of having been duped by con men who took large sums of their money and of having been brought into serious conflict with the IRS, none of these individuals would testify about his experiences.

Senator Roth questioned PSI's chief investigator Charles Morley at the hearing about the extent to which American taxpayers—average citizens—use and abuse offshore tax havens.

> Chairman ROTH. When we make statements that it is widespread, has any agency of Government or anyone else attempted to establish how widespread it is? To what extent may American taxpayers be involved in this scheme? Have you seen any studies along that line? . . .
>
> I would like you to go through, give a simple illustration for the purpose of the record, exactly how this works and what could be the legitimate purpose? There are obviously legitimate purposes in sending money overseas.
>
> Mr. MORLEY. Yes sir, I think there are. As I have said, we talked to a large number of experts and in almost every case, I posed that very question to them because we, of course, did not want to interfere with the chain of commerce. It is their virtually unanimous opinion that a person would have a legitimate use of an offshore bank or company under several circumstances. One would be that they were putting the money into the Eurodollar market, Eurocurrency market, otherwise involving themselves in European bond deals.
>
> Another situation would be if a person had a legitimate business offshore, if they were importers or exporters or have a business in the Turks and Caicos. Another one would be if they were a vacationer to a place offshore. Other than that, I have come up against a blank wall as to other viable reasons. So it appears to me that unless these people are in one of those niches, the only other possible reason that I could draw would be that it was for tax purposes, by that I mean tax evasion purposes.[8]

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[8] Hearings, p. 106.

LESSONS ON HOW TO ESTABLISH AN OFFSHORE BANK

During the second phase of the subcommittee's investigative work, an attempt was made to determine why an individual would purchase a bank in such "nonfinancial" centers as the Northern Marianas, Montserrat, or St. Vincent, where a large capital base and banking experience are not requirements of doing business.

Today, a new breed of entrepreneur peddles these foreign banks (as well as trusts and corporations), to the public at large, appealing to the clients' desire for wealth, power, and especially, secrecy. One bank broker establishes his base of operations in a foreign country, acquires a resident agent, and purchases licenses from the government for the establishment of Class B, offshore, or "brass plate" banks (so-called because they consist of little more than a file in a resident agent's drawer and a brass door plate trumpeting their existence). This type of bank is permitted to do business with non-residents, i.e., offshore business. Once these licenses are obtained, the broker might market his banks by using a simple advertisement in the classified section of a newspaper or a sophisticated marketing scheme.

The sales pitch for an offshore bank usually takes one of two forms. First, the prospective client may be told of the many ways in which a bank can be profitable. For example, it supposedly can attract flight capital from rich South Americans and Europeans who are trying to find a place to hide vast amounts of money. Second, the prospective client is told that banking, currency and securities laws in the United States have all but destroyed the type of individual capitalism upon which this country was founded and that secrecy helps to overcome "the yoke of regulation". In order to present an overview of offshore bank brokers the subcommittee scrutinized the WFI Corporation as well as some smaller brokers.

WFI CORPORATION

WFI Corporation of Los Angeles was incorporated in March of 1975, with Jerome Schneider as principal owner and president. WFI President Schneider describes himself as a financial consultant who became interested in offshore banking in the early 1970's when his clients requested information on establishing banks outside the United States.

In 1975, Schneider used WFI to establish corporations in the Cayman Islands for resale to clients interested in that island's tax and secrecy laws. WFI branched out from 1976 to 1979 by selling bank licenses in St. Vincent and Anguilla. According to Schneider, a bank was sold by WFI every other month during that 3 year period. These banks could be formed by WFI for less than $10,000 and were resold to WFI clients for as much as $37,000 each. In January 1980, WFI established its first licensed bank in Montserrat. Since that time WFI claims to have licensed 50 banks in Montserrat.

As WFI sold more licenses, the company branched out into other areas to attract interest. WFI conducted "International Conferences on Offshore Banking" in various cities. Prospective clients paid several hundred dollars to hear Schneider and other speakers tout offshore banking in general and WFI in particular. Attendees received numbered tags rather than name tags. Video tapes of these conferences were offered for sale. A WFI newsletter, "The Offshore Moneyline", offered advice on the uses of offshore banks.

In January 1982, Schneider traveled to several Pacific jurisdictions to talk with government officials concerning the expansion of WFI's activities. The areas visited included Palau, the Marshall Islands, and the Northern Mariana Islands.

In an interview with PSI staff, Schneider stated that he chose the Commonwealth of the Northern Mariana Islands (CNMI) as his principal Pacific location because of its close ties with the United States and because the government of the CNMI responded well to his proposals to encourage offshore "brass plate" banks. In March 1982, Emergency Rules and Regulations for Licensing of Offshore Banking Corporations were issued by the government of the Marianas. According to Mr. Schneider, these rules and regulations were encouraged by him in order to provide adequate supervision of offshore banks. The regulations provided for capitalization of an offshore bank with $10,000 cash, did not require the owners or operators of an offshore bank to have prior banking experience, and provided a certain level of secrecy for the bank's operations and transactions.

In an August 1982 publication, WFI cites the Emergency Regulations in labeling the Marianas as ". . . one of the best locations in the world to own an offshore bank." WFI touts the secrecy of offshore banking in the CNMI by quoting the regulations: "No information provided in compliance with these regulations shall be furnished to any third party . . ." Significantly, WFI stops quoting at this point when in fact the regulations state in full: ". . . except upon court order, subpoena, other judicial process or the express consent of the parties involved."

In an "Offshore Bank Offering Memorandum" distributed in 1982 and in a September 16, 1982 "Status Report", WFI claims that neither the banking nor the securities laws of the United States apply to the Northern Mariana Islands. Circumvention of these regulations is offered by WFI to prospective clients as an advantage to owning an offshore bank in the Northern Marianas. These claims have been adamantly refuted by both United States and CNMI government officials with whom PSI spoke.[9] The CNMI House of Representatives subsequently passed a bill raising the licensing fee of offshore banks to $50,000, but CNMI Government officials admit that they are inexperienced and ill-equipped to deal with the complex issues involved with offshore banking and the controversy has not yet been completely resolved by the CNMI government.

Following implementation of the March 1982 Emergency Regulations, WFI obtained 50 offshore bank licenses in the CNMI. Since that time, WFI sold at least 38 of the licenses to third parties for prices ranging from $20,000 to $35,000. On May 12, 1983, the Speaker of the House of Representatives of the CNMI told PSI that the CNMI government issued new Emergency Regulations governing offshore banking which raised the capitalization requirements to $250,000. These new regulations may restrict the establishment of additional offshore banks and the renewal of licenses of those already in existence. In fact, according to Marianas officials, as of May 12, 1983, none of the 38 WFI brokered banks had renewed their licenses. PSI has learned that recently 16 retail or class A bank licenses have been granted to certain parties in the CNMI for potential resale to third parties. Considering the size of Mariana Islands (population approximately 17,000) this appears to exceed any likely need.

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[9] Mr. Daniel McMeekin, Executive Director of the Northern Marina Islands Commission on Federal Laws, told PSI staff that, in his opinion, the banking and securities laws of the United States, with few exceptions, do apply to the Northern Mariana Islands.

As a result of the new Marianas legislation which appears to have effectively terminated WFI's brokerage of banks there, WFI changed its selected banking center, this time to what its September 1984 announcement calls the four "Switzerands of the Pacific". The brochure states "Four Pacific islands are quietly emerging as the next major banking/tax haven centers of the world. These 'Switzerlands of the Pacific', as they are becoming known are: Vanuatu. . . . The Marshall Islands . . . Nauru . . . and the Cook Islands. They offer you the stability and secrecy of Swiss banks, while paying far higher interest. In fact, their banking secrecy laws are stricter and less penetrable than Switzerland's."

Thus the search for a foolproof haven continues . . . from Anguilla to St. Vincent to Montserrat to the Northern Marianas and now Vanuatu, The Marshalls, Nauru and Cook Island.

WFI contracted with a private firm to conduct background checks on prospective clients and apparently continues to run such checks on its own. WFI claims, in a promotional brochure, that it established offshore banks "within strict legal guidelines and following the most careful screening of applicants." There is, however, no assurance that an individual purchasing a license will be the equitable or beneficial owner. In fact, the contrary is often true. PSI staff has found several cases where the WFI-listed owner was an agent or attorney used by a principal to purchase the bank. In most of these cases the agent was contacted and told PSI that he had no idea how the bank had been used, if it had been used at all. This point was emphasized by Senator Rudman during his questioning of Jerome Schneider at the hearing:

> Senator RUDMAN. Are you aware of the fact, with the exception of Pacific International, each of these people was interviewed, they were all agents, they may have no knowledge of how the banks are used by the principals, they went to you as an agent and immediately thereupon transferred ownership after you gave them the license which you owned, are you aware of that?
>
> Mr. SCHNEIDER. No; I am not aware of that.
>
> Senator RUDMAN. Can we agree for the purposes of the record, because we are building a record here, your process really doesn't work all that well, I can go through a lot more with you if you like and I am not criticizing you, I simply say if people lie to your face unless you have some powers the rest of us don't possess, you probably take them at their word absent some suspicious conduct, is that true?

Mr. SCHNEIDER. Yes, sir. . . .[10]

PSI's review of WFI subpoenaed records could account for only 77 banks of the 150 banks claimed by WFI. These 77 banks were owned by 60 different clients while WFI was the owner of record of the remaining banks. PSI staff attempted to contact the 60 owners of record, but met with only limited success. Of these 60 owners, 29 could not be located in the city listed on their WFI application or they declined to be interviewed by PSI. Despite exhaustive attempts, PSI was unable to speak with these 29 bank owners.

PSI staff was able to locate and speak with the 31 remaining owners, 12 of whom were by that time former owners. Six of these former owners claimed never to have been able to use their banks. All six felt that they followed WFI's instructions but were unable to utilize these "brass plate" banks as they expected. For example, they were unable to open accounts in their bank's name at commercial island banks. They could not, without a great deal of additional resources, engage as the international trading or speculating WFI had represented.

Three other former WFI bank owners felt they may have been able to operate a bank successfully, but that economic conditions precluded them from putting in the amounts of money they would have been needed to make a bank work. Two other former owners each bought banks for the company in which they were employed. Each then left their respective companies. With no one to look after the banks, the licenses were allowed to lapse. The remaining former bank owner claims to have been duped into opening a branch office for a fraudulent securities scheme operated by another WFI bank owner whom PSI staff was unable to locate.

PSI staff also contacted 19 individuals who stated that they were current owners of WFI chartered banks. Eight of the 19 said they have been unable to use their banks for the purpose they initially intended. More than half of those unable to use their banks said they felt that WFI had been misleading in its promotion of offshore banks. Six other owners admitted that they had purchased a WFI bank but would not discuss its use. Most made passing reference to the tax advantages of having an offshore bank.

Two other owners were agents for a principal whose name they would not divulge. Neither seemed to have any idea of how the principals were using the banks, nor did they express concern.

Two owners claimed to have actually used their banks. One owner is a Lebanese national who purchased a WFI bank to provide for anonymity for his investments due to the lack of political stability in Lebanon. What these investments were and how they were made was not divulged. The other owner was J. David Dominelli, the president of J. David Banking, a California company which allegedly traded foreign currency. Dominelli was recently indicted on multiple counts of fraud due to the alleged misuse of his bank and other companies he owned. At the time of its collapse, the J. David empire had reportedly taken in over $100 million.

Dominelli bought a bank in Montserrat from WFI. In an interview, he told PSI investigators that most of his foreign currency trading was run through this bank and thus, according to Dominelli, protected by Montserratian secrecy laws.

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[10] Hearings, p. 189.

Shortly after J. David's fall, Dominelli fled to Montserrat; however, the country's officials cut his stay short and ordered him off the island. He was subsequently arrested and is now awaiting trial in San Diego.

It is unclear how much J. David Banking made or lost in trading its customers funds on the foreign exchange markets. In fact, no one knows if such trades were ever made. Perhaps the true story will surface during Dominelli's criminal or bankruptcy proceedings. The fact that Dominelli misrepresented the Montserrat secrecy laws to all who inquired is really academic at this point.

In summary, a 1981 WFI sales brochure lists 12 WFI-established banks as evidence of its success. Of the 12, PSI found: no WFI records of 2, allegations of WFI misleading the owners of 2, phony checks passed by 1, and another used in a securities fraud case.

CO-OP INVESTMENT BANKERS—"CAPITALIZING" AN OFFSHORE BANK

The subcommittee's exhaustive review of the WFI Corporation records led to information about how a Washington area company, claiming to be a mortgage banker, Co-op Investment Bankers of Rockville, Maryland, is involved in offshore banking. Staff Counsel Thomas Karol explained at the May hearing that PSI contacted the officers of Co-op/Maryland, Aleksandrs Laurins and Charlene Baden, but both were uncooperative and refused to provide the subcommittee with any useful information. The subcommittee therefore subpoenaed Co-op's records from the National Savings & Trust Co. in Washington, D.C. These records showed that Laurins and Baden, through Co-op/Maryland, established an NS&T bank account for Co-op Investment Bank, Ltd. referred to as Co-op/St. Vincent, and agreed to provide the capital for the St. Vincent's bank. To provide this capital they passed large checks between two accounts with small balances. The large checks canceled each other out.

Apparently the only purpose was to generate a large deposit ticket to be used as evidence of capitalization. The Co-op/St. Vincent's deposit ticket was sent by Laurins to broker Jerome Schneider of WFI and then to the Government of St. Vincent as proof of sufficient capitalization. A license was then granted by that government to operate the Co-op/St. Vincent's bank:

> Chairman ROTH. So it was a wash, is that what you are saying?
>
> Mr. KAROL. Yes, it was, Mr. Chairman.
>
> Chairman ROTH. What was the purpose of that?
>
> Mr. KAROL. We asked the managing director and vice president of the NS&T Bank if there could be any purpose for this. He said the only result of this transaction was to generate a deposit ticket which inaccurately reflected funds on deposit that day.
>
> Chairman ROTH. In other words, to the extent there were any requirements of capital, it was a loophole or a way around, a fraud. Basically, there wasn't any capital; is that correct?

> Mr. KAROL. That is correct, Mr. Chairman. The chart on my right clearly shows the Co-op/Investment Bankers of Maryland; the column on the left had a beginning balance of less than $3,000. Yet on November 20, 1978, at exactly 2:02 p.m. Charlene Baden wrote a check for $187,500 which was deposited into the Co-op/St. Vincent's account. This was drawn on the Co-op/Maryland account and signed by Charlene Baden.
>
> On the memo portion of the check it states, "required initial share of capital." At the same moment from the Co-op/St. Vincent's account, with deposits of only $400 that day, a second check for $187,500 was drawn and returned to the Co-op/Maryland account which resulted in the generation of another deposit ticket. The first deposit ticket and check were sent along with a letter from Mr. Laurins to Jerome Schneider of WFI, which I would like to read:
>
>> Dear Jerry, enclosed herewith are copies of our resolution, check, and deposit slip showing that $187,500 has been paid in as capital for Co-op Investment Bank Ltd. to its organizational account at the National Savings and Trust Company.
>>
>> Please forward this information to the St. Vincent Trust Authority and request they provide the new Bank with the letter acknowledging authorities to start the conduct of banking business.
>
> A year later, Baden and Laurins, and Mr. Schneider as attorney-in-fact, applied for and received another offshore bank license in Anguilla. This same type of transaction took place again in 1979. . . . This time the beginning balances are only $14.07 and $100. An identical check was immediately returned to the Co-op/St. Vincent's account. The only result of this transaction was a generation of a deposit ticket in the exact amount needed for capital by the nation of Anguilla.[11]

Thus, while the subcommittee found that legitimate offshore bank use requires substantial capitalization, the evidence obtained indicates that the Co-op banks may not have been capitalized at all and may have used suspect, if not fraudulent, methods to appear to be capitalized.

A second question addresses safeguards offered by nation's granting such banking licenses. With respect to Co-op, the governments of St. Vincent and Anguilla may have been deceived by the phantom capitalizations or may have realized the charade and not reacted. The fact that a mere deposit ticket is accepted by these governments as evidence of capitalization is, in any case, symptomatic of their regulatory efforts.

FEDERAL LAW ENFORCEMENT EFFORTS

Federal law enforcement officials who testified at the 1983 hearings expressed similar concerns and frustrations about their efforts to curtail abusive uses of offshore tax havens. Roscoe Egger, Jr., Commissioner of the Internal Revenue Service, noted:

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[11] Ibid., p. 175, et seq.

> From our perspective at Internal Revenue the problem with tax havens is pretty clear. In two words: Tax evasion. . . . The real victims in this whole widespread evasion are the honest taxpayers in this country who do pay their fair share of the tax burden while an unscrupulous handfull of individuals are evading their responsibilities. This situation is unhealthy for our voluntary self-assessment system because to a considerable degree the activities in these tax havens involve narcotics traffickers and other elements of organized crime and it is equally unhealthy for the economic and social structure of our country as a whole.[12]

When called upon to testify about the nature of the tax haven problem, the Assistant Attorney General in charge of the Justice Department's Tax Division said:

> Suffice it to say we believe that the scope of the tax haven problem is huge and that efforts to combat it have not reached a desirable and necessary level. All law enforcement agencies dealing with these problems believe that the use of offshore banks and other entities for illegal purposes continues to grow.[13]

And Robert B. Serino, Director of Enforcement and Compliance, Office of the Comptroller of the Currency, echoed a similar concern:

> Certain offshore banks have caused serious losses to individuals and institutions through fraudulent operations. The crisis, however, is not the size of any one loss to any one person or bank, as much as it is to the volume of such frauds being perpetrated upon a substantial number of people throughout the world. We in the Enforcement Division of the Comptroller's Office receive hundreds of calls detailing problems and complaints from individuals such as bankers or individuals because they have been approached or offered paper from an institution or one of the shell banks. At present we are aware of approximately 125 banks that may have been involved in fraudulent operations.[14]

In solving offshore crimes the government investigator and prosecutor are faced with several enormous obstacles all of which are complicated by the issues of extraterritoriality and sovereign rights. First, it must be discovered where and when money laundering, fictitious entities, and sham transactions have occurred or are being used. Second, sufficient information and leads to follow the complex schemes used must be developed. Third, documents and testimony that will be admissible in court to prove the criminal violations must be obtained.

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[12] Ibid., p. 15 et seq.

[13] Ibid., at p. 8.

[14] Ibid., at p. 147.

The mechanics of a money laundering scheme can be as simple as a wire transfer from an American bank to a foreign one. But a variety of complexities and dodges usually combine to make this basic process almost impossible for authorities to crack. In the words of IRS special agent Raul Dearmas, here is one way in which a secrecy operation works:

> Let us assume the domestic narcotics trafficker buys 100,000 pounds of marijuana. He pays $200 a pound. He would then get a profit of approximately $100 pound. The money will come to him little by little. At one point in time, he will have accumulated millions of dollars. So what can he do with that money? By creation of offshore operations, he is able then to buy legitimate businesses in this country and is able to invest in other businesses outside of this country. He is able to bring some of his narcotics profits back into the banking system by using these offshore banks and offshore corporations. We have specific cases in which individuals, one individual has formed 12 corporations in Panama, Caymans, Netherlands Antilles, Bahamas and . . . an island off the coast of Great Britain, which I never knew they were using that island as an offshore, but through that corporation, he channeled, he was able to channel back into the United States $3 million in currency from 1980 through December 1981.[15]

The problem of how to channel offshore dollars back to the United States undetected is alleviated by the haven country's secrecy laws. In the haven, the American buys a shell corporation. Then, in the name of that corporation, the American deposits money in a bank authorized to do business with foreigners. Under the protection of the haven's secrecy laws, the corporation can transfer the money to the local branch of a large international bank. Next, the American borrows money from the branch in the name of another corporation. The records of the bank in the U.S. fail to disclose what has happened because they show only a deposit by one company and a loan to another company that investigators cannot identify or trace.

The penetration of a single secrecy law in order to trace funds can sometimes prove an insuperable task. To follow the money path halfway around the world and back is usually impossible. In the case known as *Interconex,*[16] it took Justice Department prosecutors 3 years to trace a $2 million shipping contract overcharge through Swiss accounts of Liechtenstein companies to banks in Bermuda and the Caymans. Then, when prosecutors needed to link one of the perpetrators with $1 million that went into the Cayman accounts, the islands' banks refused to turn over records. Finally, after the Grand Cayman Court refused to force disclosure, an appeals court ruled that disclosure is mandatory if the request is for specific documents relevant to a prosecution in which charges have been filed, and if the offense would be a crime in the Caymans. All of these elements were present in the *Interconex* case. The Department of Justice, however, knows that the *Interconex* case is not a panacea for haven secrecy. Such procedures are extremely costly, time consuming, and viable only after indictment. Moreover, important antecedents such as *United States* v. *Field,* in which a Cayman banker's assertion of the Fifth Amendment as well as Cayman Bank Secrecy in his refusal to testify at a U.S. grand jury were rejected, show that the extraterritorial use of subpoenas can result in hostile international reaction.[17]

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[15] Ibid., at p. 130.

[16] See "Cayman Isles' Secrecy Lid Pried Loose by Precedent-Setting U.S. Fraud Case" by Robert E. Taylor, The Wall Street Jounal, January 11, 1983, at p. 52 et seq. of the Hearings; and Hearings, pages 211 et seq.

John Fedders, Director of Enforcement for the Securities and Exchange Commission, told PSI that the dramatic increase of foreign participation in the U.S. securities markets [18] means that secrecy havens can effectively hinder SEC investigations of insider trading, market manipulation, selling securities without registration, and failure to disclose acquisitions of corporate control. For example, the agency had started litigation in October 1981 regarding purchases of common stocks and call options for Santa Fe International just before announcement of the merger of Santa Fe and Kuwait Petroleum Corp.[19]

After lengthy discussions with the defendants' counsel and the government of Switzerland, a decision was made to apply for assistance pursuant to the 1977 U.S.-Swiss Treaty on Mutual Assistance in Criminal Matters. That request was made in March 1982. In January 1983, the Swiss Federal Tribunal denied the requested assistance. Since that time the Commission has sought other avenues, short of compulsory measures, to learn the customers' identities. To date, efforts have failed. As a result, the litigation was stalled while an inordinate amount of resources were consumed.[20]

Yet in the case of *SEC* v. *Banco della Svizzera Italiana,* which involved transactions in the common stock and call options for the common stock of St. Joe Minerals Corporation, the Commission successfully combated foreign secrecy laws through litigation. After the bank in that case refused to provide needed information, the Commission filed a motion in Federal court seeking to compel production of the requested information. The Commission's motion was granted and the bank was ordered to either disclose its customer's identity or risk sanctions. Subsequently, the bank obtained a waiver from its customer and produced the requested information.[21]

The response of the Commodities Futures Trading Commission to a similar situation in the case of *Bank Populaire,* again shows quite a different Federal posture: here the bank was barred from trading by the CFTC as it would not reveal its clients.[22]

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[17] *In Re Grand Proceedings, United States* v. *Field,* 532 F.2d 404 (5th Cir. 1976.)

[18] Hearings, p. 135. According to Fedders, from 1978 to 1982, transactions in the U.S. by foreign financial institutions involving stocks and bonds increased from $23.6 billion to $53.1 billion. Total foreign investment in the U.S. increased from $25.6 billion in 1971 to $42.4 billion in 1978 and to $99.2 billion in 1982.

[19] Ibid., at p. 139.

[20] Ibid., at p. 323.

[21] Ibid., at p. 324.

[22] In the matter of *Bank Populaire, Suisse,* Comm. Fut. L. Rep. (CCH) § 21, 255 (CFTC 1981), *See also, In the Matter of Wiscope, S.A.,* 604 F.2d (2d Cir. 1979).

Of the more recent concerted and coordinated efforts of Federal law enforcement officials, several major cases have been cracked in which the dollar yield has been enormous. IRS Commissioner Egger told PSI of one such example at the 1983 hearing:

> In the Seattle-based operation involving an illegal tax shelter program where hundreds of individuals in several States were involved, five leaders were convicted in the conspiracy to cheat the Government out of millions of tax dollars. They attempted to do this by creating fraudulent deductions stemming from sham transactions between investors in foreign trusts which were set up in the British West Indies and Central America. A good deal of evidence in this case came from taped conversations which were recorded by our undercover agents in the investigation stage.[23]

Other Federal law enforcement efforts relating to the offshore problem have been previously concerned with drug trafficking.

In 1980, Treasury's Office of Enforcement and Operations, with the cooperation of the IRS, Customs, and the Department of Justice, developed Operation Greenback. It is an integrated investigation of the huge surplus of currency in the Federal Reserve banks in Florida, which grew from $1.5 billion in 1976 to a peak of $5.8 billion in 1980. In 1982, it declined to $5.3 billion. The Operation has been based primarily on two concepts. First, that an attack on the illegal activity associated with the currency could be made through the financial operations of the violators. Tax laws and the reporting and recordkeeping requirements of the Bank Secrecy Act[24] could be effectively employed in this effort. Second, the criminal investigation should be integrated through the use of the grand jury process with Federal prosecutors coordinating all of the related investigation.

Since the inquiry is being conducted under the authority of the grand jury, all of the Federal agents participating in it can pool information including tax or other financial information. This kind of sharing, which streamlines the investigative process, is not permitted under the procedures governing administrative inquiries.

Operation Greenback has documented $2,729 million in U.S. currency that has been laundered through international transactions by seven different organizations. During the 5 months of operation ending September 30, 1984, Treasury has seized more than $40.8 million in currency. In addition, property in excess of $14.8 million has been seized. Appearance bonds in excess of $4.9 million have been forfeited and jeopardy tax assessments totaling more than $112 million have been made. There are approximately 40 special agents from IRS and Customs assigned to Operation Greenback.

By 1983, through the combined efforts of the IRS and the U.S. Customs Service, there were approximately 323 indictments and 122 convictions and approximately 90 cases pending trial.

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[23] Hearings, p. 23.

[24] See discussion of the Bank Secrecy Act, infra, at p. 20, et seq. Currency and Foreign Transportation Reporting Act, Title 31, U.S. Code, § 1051–1143 (1970); see also regulations § 103.11–103.51.

Although Operation Greenback cases in Miami tend to overshadow other cases, a large number of significant Bank Secrecy Act investigations have been undertaken in many cities across the country. According to Treasury and Justice more than 40 financial investigative task forces have been established throughout the United States and Puerto Rico modeled after Operation Greenback.

For good reason Operation Greenback has been aimed almost exclusively at the laundering of drug money. The consequence, however, is to leave virtually untouched many of the so-called "white-collar" criminals who may be just as guilty of violating the reporting requirements of the Bank Secrecy Act.

THE BANK SECRECY ACT

The Federal Government's means of monitoring large cash transactions and the export and import of large amounts of cash is the Currency and Foreign Transactions Reporting Act of 1980, popularly known as the Bank Secrecy Act. At the 1983 Senate hearing, U.S. Customs Service Commissioner William von Raab noted that "where large sums of money change hands, there you will find the soft underbelly of organized crime, and that is what the Bank Secrecy Act enables us to attack." [25]

Under this act and its regulations prior to 1984: (1) a bank or other financial institution is required to file a currency transaction report (CTR or form 4789) with the IRS for each deposit, withdrawal or exchange of currency or monetary instruments in excess of $10,000; (2) a person must file a report (CIMR or form 4790) with the Customs Service when physically transporting into or out of the United States any currency or monetary instruments exceeding $5,000 at the time of entry into the United States or at the time of departure, mailing or shipping from the United States; and (3) a person who owns or controls a foreign financial account must declare such ownership or control on that person's Federal income tax return and also file form 90-22.1 with the Treasury Department. (Amendments to the act are discussed, infra).[26]

These requirements were intended to disrupt the laundering and outflow of cash from criminal enterprises which have traditionally dealt in cash, particularly drug trafficking. But it was recognized from the start that enforcement might be difficult. As the Senate Report on the 1970 act observed:

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[25] Hearings, p. 67.

[26] The following table, supplied by IRS, shows the trend in responses to questions on Schedule C of the income tax form 1040 concerning the taxpayers interest in a foreign bank account or a foreign trust:

	Yes to both	Yes-bank	Yes-trust	At least one "no" box checked
Year:				
1982	5,911	140,859	1,983	20,480,414
1981	9,431	167,623	4,293	18,775,817
1980	3,803	151,259	642	16,639,151
1979	6,303	139,864	871	15,354,353

> Reports are not a foolproof method of preventing organized crime from sending currency out of the country. Obviously, a criminal who is already breaking the law could just as easily ignore the reporting requirements. The significance of requiring reports is that it provides the Justice Department with another means of obtaining a conviction. The mere failure to file a report would constitute a criminal violation much easier to establish compared to proving the funds transported were illegally acquired or were to be used for an illegal purpose. Those who fail to report would be subject to a criminal penalty of a year in prison, a $1,000 fine or both. If the failure to report was committed in furtherance of the commission of any other violation of Federal law, or as part of a pattern of illegal activity involving transactions exceeding $100,000 a year, the person who fails to file a report is subject to a much stiffer penalty—5 years in jail or a $500,000 fine, or both. Finally, any unreported currency is subject to seizure and forfeiture to the United States and those who fail to make required reports are liable for a civil penalty equal to the amount of currency transported less any amount already seized or forfeited.[27]

The Treasury Department sees the twin reporting requirements by banks and by travelers as interrelated, at least theoretically. For example, if banks were not required to report large currency transactions, there would be little need for criminals to smuggle money into or out of the country. Currency simply could be taken into banks and the funds transferred abroad to a secret bank account without disclosing the identities of the persons arranging the transfer or receiving the funds. Conversely, without reports on the import or export of currency, the requirement that banks report large currency transactions would be relatively ineffectual. Criminals could easily travel to a nearby foreign country and convert their currency into a more compact and more profitable form of wealth.

Some criminals have done just that, at minimal risk and with total impunity. An exchange between Vice Chairman Rudman and convicted narcotics dealer Harold Oldham at PSI hearings on international narcotics trafficking in November 1981 is illuminative:

> Senator RUDMAN. When you left this country, did you ever go to Caymans when you were carrying large amounts of cash?
>
> Mr. OLDHAM. Yes.
>
> Senator RUDMAN. Was there ever any questioning by anyone?
>
> Mr. OLDHAM. No, sir. At that time, the primary access to the Caymans was through Miami Airport and the flights to the Caymans left out of Gate No. 1. Gate No. 1 was the only gate at the Miami Airport and to my knowledge almost any airport in the United States that did not have

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[27] Senate Report 91-1139 to accompany S. 3678 on Foreign Bank Secrecy and Bank Recordkeeping, p. 7.

> metal detecting devices or any security of any kind. Gate No. 1 was before you walk through any security area. I cannot explain this. I only know at that time it was easy just to walk from the ticket counter onto the aircraft without any examination of any kind.
>
> . . . I would fly down in the morning with cash. The corporate representative would meet me at the airport and take me to his office. We would contact the various banks to determine what their going rate was that day to convert U.S. currency into cashier's checks and we would bring the money to the bank and convert it to a cashier's check.
>
> I would then fly back the same day with the cashier's check. I took the money down but I brought it back in another form the same day.
>
> Senator **Rudman**. How much money did you launder in all?
>
> Mr. **Oldham**. Roughly half a million dollars.
>
> Senator **Rudman**. Over a period of how long?
>
> Mr. **Oldham**. Over a period of about 2 years, I believe.[28]

The Bank Secrecy Act imposes on the Secretary of the Treasury the responsibility for insuring compliance with the act. In enforcing the requirement that banks file the form 4789 for large cash transactions, the Secretary may delegate responsibility to the various bank regulatory agencies: the Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board. Consequently, a uniform bank examiner's checklist was developed by Treasury and the regulatory agencies. In addition, guidelines were agreed to for the disposition of any violations reported by examiners for these agencies.

But it took several years for these procedures to be perfected and even longer for them to become partially productive. One perfecting session took place in 1975 after it had become "apparent that bank examiners had not detected some serious violations of the currency transactions reporting requirement," the Treasury Department said in 1979. But then, it admitted: "The number of referrals to our Enforcement office, however, has remained very low." [29]

How low was indicated by statistics on bank reporting violations discovered by the Comptroller of the Currency. In 1977, its examiners discovered only 13 "separate potential violations" of the CTR requirement. The next year, the number had risen to only 46.[30]

The record of Federal Reserve Board examiners, which regulates FRB member banks, was equally dismal. From 1977 through the first quarter of 1979, out of about 1,000 banks examined each year, the FRB found only 49 banks in violation of the form 4789 reporting requirement.[31]

It is clear that in the past both the Federal Reserve Board and the Comptroller of the Currency gave low priority in their bank examinations to the transaction reporting requirement. In 1979, the FRB said flatly that "no violations warranting criminal referral have been discovered by its examiners." [32]

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[28] PSI Hearings, International Narcotics Trafficking, November 17, 1981, pp. 285–286.

[29] Hearings, Offshore Tax Havens, House Ways and Means Subcommittee on Oversight, April 24 and 25, 1979, p. 377.

[30] Ibid., p. 349.

[31] Ibid., at p. 349.

The Comptroller of the Currency took essentially the same posture saying: "The examination process, whether applicable to domestic or foreign units of U.S. banks . . . principally focuses on the determination of the bank's financial condition and whether it is operating in a safe and sound manner." [33]

Both agencies also noted a legal impediment: The Right to Financial Privacy Act of 1978. The Comptroller said: "That act significantly restricted the (Comptroller of the Currency) from transferring financial records of bank customers or information derived from other agencies or departments . . . Thus, if in the course of an examination of a national bank a 'questionable transaction' involving customer records was encountered, the (Comptroller) could report the relevant facts to IRS or any other government agency only upon our determination that such transaction appeared to be evidence of a past or potential violation of law administered by the other agency." [34] Though some of these impediments could be removed by liberalizing the regulations under the Right to Financial Privacy Act, such remedies have not yet been initiated.

It was not until the late 1970's and early 1980's that the Government began to act against what had become obvious noncompliance with the act's reporting requirements. A 1979 Treasury Department study revealed tremendous amounts of excess currency in Miami which by that time had become a large gateway for illicit drugs from South America; its currency surplus was one fallout from South Florida's burgeoning drug traffic.

U.S. investigators and prosecutors, backed by grand juries with authority to investigate both Title 18 (criminal) and Title 26 (tax) offenses began to move against Florida banks which had routinely accepted large amounts of cash, sometimes brought in paper sacks or suitcases, but had neglected to file the required reporting forms. The Treasury Department meanwhile tightened regulations which had permitted banks wide discretion to exempt some of its customers from the reporting requirements. At the same time, Federal law enforcement authorities began moving on other fronts. Throughout Florida, they identified and prosecuted illicit private money launderers, and set up their own money-laundering "sting" operation in Miami. The result of Operations Greeenback and Banco was numerous indictments against bankers and bank employees, drug dealers, couriers, and money launderers. In the 8 months ending in June 1984, Greenback accounted for 52 indictments involving 184 defendants. One such defendant was the Great American Bank of Dade County. The bank pled guilty to four felony counts relating to laundering over $94 million during a 2 year period.[35]

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[32] Ibid., at p. 333.

[33] Ibid., at p. 332.

[34] Ibid., at p. 338.

[35] Testimony of John Keeney, Deputy Assistant Attorney General, before the Subcommittee on General Oversight and Renegotiation of the House Committee on Banking, Finance and Urban Affairs June 20, 1984.

During the 98th Congress, Chairman Roth introduced legislation, S. 902, to expand the Customs Service's search authority under the Bank Secrecy Act. This was incorporated into the Comprehensive Crime Bill of 1984, S. 1765 and passed in 1984. Questions regarding the constitutional propriety of Customs officers conducting warrantless searches of outbound travelers based upon reasonable cause were addressed by a Treasury Department enforcement official who testified at PSI hearings in November 1981. "It (is) the Treasury Department's position, then supported by the Justice Department as it is now, that the well established Customs border search authority extends equally to exiting as well as incoming travelers." The official cited "ample authority" for Treasury's position.[36]

Yet, despite favorable case law supporting a broad application of Customs border search authority to exiting travelers, agents and inspectors have been reluctant to use it in unreported currency cases because of the express probable cause-warrantless search requirements of Section 235 of the act and its underlying legislative history. This reluctance is predicated, in part, upon a fear of incurring personal liability. The following incident was described as being illustrative of Customs' dilemma:

> Customs agents received unverifiable information that a Peruvian alleged cocaine smuggler would be leaving Los Angeles International Airport for Lima, Peru, later that day on a Braniff flight. After deciding to interview the man, they followed him to a boarding platform area and noticed that he appeared nervous, perspired heavily, and met with an unidentified Latin man who gave him a black plastic bag.
>
> As the Peruvian was about to board the plane, the Customs agents stopped him and advised him of the currency reporting requirement. He replied that he was aware of the requirement but was not carrying more than $5,000. The agents asked if they could search his luggage. He refused. Thus, because probable cause could not be established, he was allowed to board the plane.
>
> However, at the request of DEA authorities, Peruvian customs officials arrested the traveler on his arrival in Lima and found $95,000 in cash in his luggage.

Another vivid example of the legitimate need for an outbound search authority in Customs occurred May 4, 1983. On that date, Customs and IRS agents stopped a Lear jet as it taxied for takeoff from Fort Lauderdale bound for Panama. They confiscated almost $5.5 million in cash. Later, at the home of one of the passengers, the agents found 62 pounds of cocaine valued at $18.5 million, 15 weapons and $40,000 in counterfeit bills.[37]

But despite some successes with the Bank Secrecy Act, the list of unknowns is long: Despite the requirement that each $5,000 or more in currency exports or imports of currency aggregating greater than $5,000 be reported by (amendment now $10,000) nobody knows how much money from criminal and noncriminal sources goes offshore and is thus hidden from the IRS. Consequently, the Federal revenue loss is unknown, although it is suspected to run into billions of dollars annually.

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[36] Hearings, P.S.I. International Narcotics Trafficking, testimony of Robert E. Powis, Deputy Assistant Secretary of the Treasury (Enforcement), November 17, 1981, p. 347.

[37] Congressional Record, Vol. 129, No. 63, May 10, 1983.

Despite the requirement that currency transactions in excess of $10,000 be reported, nobody knows how many banks fail to file such reports or what these unreported transactions actually amount to.

In fact, recent evidence indicates that regulatory oversight of compliance with the filing requirements may be deficient. For example, on February 8, 1985, the First National Bank of Boston, the oldest and largest bank in New England, pleaded guilty to knowingly and wilfully failing to file CTRs for approximately 1,000 interbank transfers of over $1.4 billion, primarily to three Swiss banks.

In a press conference, First National claimed that it failed to notice that the reporting requirement, which has applied to interbank transfers since 1980, had changed. This is currently the subject of a PSI inquiry.

Furthermore the requirement to report all foreign bank account holdings to the IRS and the Treasury Department, nobody knows how many Americans own foreign accounts, the total amount held in these accounts, or in what offshore bank or jurisdictions they exist.

Thanks to what one observer has called "the veil of tiers" [38] afforded by foreign commercial secrecy laws and the existing letters rogatory process, nobody knows how many Americans are the beneficial owners of offshore "paper" corporations through which their money is laundered.

Because the Bank Secrecy Act has not applied to wire transfers before 1984, nobody knows what percentage of the billions wired from this country every day represents earnings from criminal enterprises.

Thus, the number of offshore banks and companies owned by Americans, the size of their assets, and the extent to which they are being used for tax evasion or other unlawful purposes is shrouded in obscurity.

III. PREVIOUS CONGRESSIONAL ATTENTION

In the past 10 years, the use and misuse of offshore banks and companies has attracted the attention of several congressional committees. Since offshore operations involve such diverse subjects as banking, securities, and commodities trading, narcotics trafficking, treaties, corporate practices, taxes or any number of other areas, the congressional inquiries have understandably come from many directions.[39]

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[38] Testimony of Harvey P. Dale at hearings on offshore tax-havens before the House Ways and Means Oversight Subcommittee April 24, 1979, p. 236.

[39] The following is a chronological list of Congressional hearings and reports involving offshore entities, bank secrecy and related issues:

" 'IRS: Taxing the Heroin Barons,' volume II, Hearings, Senate Committee on the Judiciary, Subcommittee to Investigate Juvenile Delinquency, 1975.

Continued

One early public examination of offshore banking operations in the Caribbean came during 1975 hearings before the House Government Operations Subcommittee on Commerce, Consumer and Monetary Affairs. Witnesses told how the Castle Bank & Trust Co.

" 'Oversight hearings into the Operations of the IRS (Operation Tradewinds, Project Haven, and Narcotics Traffickers Tax Program),' Hearings, House Committee on Government Operations, Subcommittee on Commerce, Consumer and Monetary Affairs, 1975.

" 'Foreign and Corporate Bribes,' hearings, Senate Committee on Banking, Housing and Urban Affairs, 1976.

" 'Prohibiting Bribes to Foreign Officials,' Hearings, Senate Committee on Banking, Housing and Urban Affairs, 1976.

" 'Internal Revenue Service and Treasury Department Enforcement of the Foreign Bank Account Reporting Requirement of the Bank Secrecy Act,' second report together with additional views, House Committee on Government Operations, 1977."

"International Banking Operations," Hearings, House Committee on Banking, Finance and Urban Affairs, Subcommittee on Financial Institutions, Supervision, Regulation and Insurance, 1977.

"Currency Transaction and Transportation Reporting Requirements of the Bank Secrecy Act," Hearings, House Committee on Government Operations, Subcommittee on Commerce, Consumer and Monetary Affairs, 1977.

"Investigation of Narcotics Trafficking Proceeds (Chicago, Illinois)," Hearings, House Select Committee on Narcotics Abuse and Control, 1978.

"Offshore Tax Havens," Hearings, House Committee on Ways and Means, Subcommittee on Oversight, 1979.

"Edge Corporation Branching; Foreign Bank Takeovers; and International Banking Facilities," Hearings, Senate Committee on Banking, Housing and Urban Affairs, 1979.

"The Operations of U.S. Banks in the International Capital Markets," Hearings, House Committee on Banking, Finance and Urban Affairs, 1979.

"Patterns of Currency Transactions and Their Relationship to Narcotics Traffic," Hearings, House Committee on Banking, Finance and Urban Affairs, Subcommittee on General Oversight and Renegotiation, 1979.

"Illegal Narcotics Profits," Hearings, Senate Committee on Governmental Affairs, Permanent Subcommittee on Investigations, 1979; report together with additional views, 1980.

"Currency and Foreign Transactions Reporting Act Amendments," Report to accompany H.R. 5691, House Committee on Ways and Means, 1980. "Banks and Narcotics Money Flow in South Florida," Hearings on S.2236 (to amend the Currency and Foreign Transactions Reporting Act), Senate Committee on Banking, Housing and Urban Affairs, 1980.

"Income Tax Treaties," Hearings, House Committee on Ways and Means, Subcommittee on Oversight, 1980.

"Oversight Hearings on the Currency and Foreign Transactions Reporting Act," Hearings, House Committee on Banking, Finance and Urban Affairs, Subcommittee on General Oversight and Renegotiation, 1980.

"Home Health Care Fraud and Abuse," Hearings, Senate Committee on Governmental Affairs, Permanent Subcommittee on Investigations, 1981; Report, 1981.

"Disclosure of IRS Information to Assist with the Enforcement of Criminal Law," Hearings on S. 732 (to amend the disclosure provisions of the Tax Reform Act of 1976), Senate Committee on Finance, Subcommittee on Oversight of the IRS, 1981.

"International Narcotics Trafficking," Hearings, Senate Committee on Governmental Affairs, Permanent Subcommittee on Investigations, 1981.

"Commodity Investment Fraud," Hearings, Senate Committee on Governmental Affairs, Permanent Subcommittee on Investigations, 1982; Report with additional views, 1982.

"Improper Use of Foreign Addresses to Evade U.S. Taxes," Hearings, House Committee on Governmental Operations, Subcommittee on Commerce, Consumer and Monetary Affairs, 1982.

"To investigate the Enforcement and Effectiveness of the Bank Secrecy Act," Hearings, House Committee on Banking, Finance and Urban Affairs, 1982.

"Citicorp and the SEC," Hearings, House Committee on Energy and Commerce, Subcommittee on Oversight and Investigations, 1982.

"Crime and Secrecy: The Use of Offshore Banks and Companies," Hearings, Senate Committee on Governmental Affairs, Permanent Subcommittee on Investigations, 1983; Staff Study, 1983.

"SEC and Citicorp," Hearings, House Committee on Banking, Finance, and Urban Affairs, June 28, 1983.

"Tax Evasion through the Netherland Antilles and other Tax Haven Countries," Hearings, House Committee on Government Operations, Subcommittee on Commerce, Consumer and Monetary Affairs, 1983.

"Enforcement and Utilization of the Bank Secrecy Act of 1970," Hearings, House Committee on Banking, Finance and Urban Affairs, Subcommittee on General Oversight and Renegotiation, 1984.

"Oversight Hearings into the Bank Secrecy Act," Hearings, House Finance Committee on Banking, Finance and Urban Affairs, Subcommittee on General Oversight and Renegotiation, 1984.

"Tax Evasion through the Use of False Foreign Addresses," Hearings, House Committee on Government Operations, Subcommittee on Commerce, Consumer and Monetary Affairs, 1984.

of Nassau, the Bahamas, was "controlled" by Chicago tax law firms for the benefit of more than 300 account holders whose assets represented almost $250 million in various trusts. These 1975 hearings also chronicled the collapse or deliberate dismantling of several IRS investigations in the Caribbean, chiefly Operation Tradewinds and Project Haven, ostensibly because of methods used to obtain documents concerning the Castle Bank accounts.

In 1979, the House Ways and Means Oversight Subcommittee held hearings on offshore tax havens which illustrated the difficult task of the IRS in enforcing our tax laws on income earned or sent abroad. As Chairman Sam M. Gibbons noted, "The U.S. tax collector runs up against bank secrecy laws, numbered bank accounts, and a host of other barriers to information" concerning such income. Evidence of tax fraud was also noted. In 1980, the Ways and Means Oversight Subcommittee held hearings on U.S. income tax treaties and found that some treaties, while purporting to eliminate double taxation, were abused by third-country residents to avoid paying either this country's or a third country's tax, an abuse sometimes described as "treaty shopping." Since 1977, several Congressional committees and subcommittees have considered legislation to plug holes in the 1970 Currency and Foreign Transactions Reporting Act. These included, on the House side, the Committee on Government Operations (1977 report); its Subcommittee on Commerce, Consumer and Monetary Affairs (1977 hearings); the Select Committee on Narcotics Abuse and Control (1978 hearings); the Banking, Finance and Urban Affairs Subcommittee on General Oversight and Renegotiation (1979, 1980, and 1982 hearings); the Committee on Ways and Means (1980 report); the House Government Operations Oversight Committee on Tax Evasion—Netherlands Antilles (April 1983 hearings); and, in the Senate, the Committee on Banking, Housing and Urban Affairs (1980 hearings).

In recent years several specific abuses of offshore banks and corporations have been addressed by the Permanent Subcommittee on Investigations. PSI hearings on narcotics profits (1979), narcotics trafficking (1981), medicare home health care fraud (1981), and on commodity investment fraud (1982), began to shed some light on the pervasive use of offshore tax havens and bank or corporate secrecy for criminal purposes. As a result of these and other findings, the subcommittee instituted a comprehensive investigation of offshore banking and corporate practices in 1982, culminating in the hearings and staff study referred to previously. Extending over several days, the PSI hearings paid particular attention to the problems posed to executive agencies by offshore banks and corporations in secrecy jurisdictions. The subcommittee received testimony or statements from senior officials of the Department of Justice, Customs Service, Internal Revenue Service, Securities and Exchange Commission, Commodity Futures Trading Commission, Department of the Treasury and the Office of the Comptroller of the Currency, all of whom detailed the particular problems they have stemming from foreign secrecy and blocking statutes. This testimony, as well as others, clearly illustrated that offshore problems involve more than drug smugglers and fraud operators; "average" citizens are using tax havens to circumvent basic tax and regulatory structures of the U.S. Government.

LEGISLATION

Many legislative recommendations have resulted from this congressional scrutiny. In the late 1970's, amendments were offered to increase the threshold for reporting cash imports and exports, increase the search authority for Customs officials, and provide for informant rewards. None of these recommendations were enacted.

Senator Roth reintroduced all three of the above provisions as S. 1907 which was incorporated into S. 2572, the Violent Crime and Drug Enforcement Improvements Act of 1982, which passed the Senate (as part of the Senate's Crime Bill), was watered down in conference and vetoed by the President. That bill, which was cosponsored by several PSI members, would have increased the threshold for reporting cash imports or exports from $5,000 to $10,000; increased the civil penalty for willful violation by a financial institution, its officers or employees from $1,000 to $10,000; and raised the criminal penalty from the present misdemeanor level to a felony punishable by 5 years imprisonment, a $50,000 fine or both.

Senator Roth, along with Senators Rudman, Bentsen, Nunn, and Chiles reintroduced the bill in March, 1983 as S. 902 and it once again became part of the Comprehensive Crime Control Act of 1983. As noted, that legislation passed the Congress and was signed into law in late 1984. The new legislation also addresses critical law enforcement gaps by empowering Customs officials with warrentless stop and search authority if they have reasonable cause to believe that there is a violation or a knowing attempt to violate currency transaction requirements and allowing Bank Secrecy Act violations to serve as predicate offenses for racketeering (RICO) violations and wire tapping.

Another avenue for U.S. penetration of banking and commercial secrecy is the Caribbean Basin Initiative, proposed by President Reagan to Congress on March 17, 1982. The Caribbean Basin Initiative has since passed in both the House and the Senate although in a somewhat altered form. The House Ways and Means Committee removed the administration proposal for investment credits coupled to a rollback of secrecy laws, and instead provided for tax deductions for Americans attending conventions, seminars and similar meetings in any Caribbean country which has in force an agreement to exchange tax information. These agreements must circumvent local secrecy statutes and provide authenticated copies of unedited, original documents of evidentiary quality. In this way, it is hoped, U.S. law enforcement officials can override the secrecy laws which have been used to shield illegal activities.

In a little noticed amendment to the Omnibus Crime Act of 1984, Congress adopted an amendment first proposed by Chairman Roth, which would facilitate the introduction of foreign evidence once it is in the hands of the prosecutor. Essentially, this amendment creates a rebuttable presumption as to the authenticity of foreign business records by amending 18 U.S.C. Sections 3491–3494. It also extends the statute of limitations in cases where foreign judicial assistance is being sought by adding a new Section 3292 to Title 18. It addresses the problem posed by the Speedy Trial Act by allowing records search time to be excludable under the act. After Senate action, the amendment was picked up by Congressman John Conyers (D-Mich.) and passed the House as H.R. 5919. H.R. 5919 likewise became part of the Comprehensive Crime Control Act of 1983 and thus became law in 1984. But, it should be clear, this foreign evidence procedural provision does not make it easier to obtain the records. It merely assists in their introduction and can have the effect of eliminating the necessity of bringing foreign records custodians to the United States.

Finally, in April 1984 the Senate passed the Deficit Reduction Act of 1984, Title V of which is known as the Foreign Sales Corporation Act of 1984. Under this provision a Foreign Sales Corporation (FSC) can only be considered such if it is organized under the laws of jurisdiction having an information disclosure agreement with the United States. A tax treaty, which the Secretary of Treasury certifies carries out the disclosure purposes of the act, will also suffice.

IV. TAX HAVENS

CHARACTERISTICS

In recent years both the legal and illegal uses of tax havens by large multinational companies and individual citizens has increased. Haven jurisdictions have encouraged these offshore financial transactions through the implementation of strict secrecy laws and favorable tax structures. The formulation and implementation of these policies are the legitimate right of a sovereign jurisdiction. Unfortunately, their application tends to deny information to a country whose laws have been violated, resulting in a confrontation between sovereign territories.

According to Richard Gordon in his study for the IRS entitled "Tax Havens and Their Use by United States Taxpayers—An Overview" [40], a "tax haven" is defined as "any country having a low or zero rate of tax on all or certain categories of income, and offering a certain amount of banking or commercial secrecy."

During the PSI hearings, Internal Revenue Commissioner Roscoe L. Egger, Jr. elaborated on Gordon's definition by adding "(m)ost tax havens also possess modern communication systems, a general lack of currency controls, an aggressive policy of self-promotion, and no extensive involvement in tax treaties." [41]

A favorable tax structure is an indispensable feature of a tax haven. Although some havens do impose income taxes, the rates are low relative to other jurisdictions or are effectively lower as a result of treaties. For some of the less developed haven countries an income tax system is not practical and a license or fee system is used to generate revenues. Other countries, such as Panama, impose substantial domestic taxes but a low or zero rate on income from foreign sources. Because of these differing attitudes toward income taxes, most haven jurisdictions do not recognize tax evasion as a crime and refuse to assist in any investigation of a U.S. citizen suspected of evasion, even though laundering income through the haven may have been the primary means of evasion.

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[40] Tax Havens and Their Use by United States Taxpayers—An Overview," by Richard A. Gordon, Internal Revenue Service, January 12, 1981. Also referred to as the Gordon Report.

[41] Hearings, at 15.

The second requirement of a tax haven, secrecy, refers to the confidentiality given to persons transacting business—especially with banks. Bank secrecy has important underpinnings in British common law and has been adopted by virtually all present or former British colonies. Some countries have strengthened and broadened the common law by enacting statutes with the tax haven trade in mind, the unfortunate result of which has been to render vital information virtually impossible for foreign government investigators to obtain. For example, the Bahamas has a bank secrecy provision found in Section 10 of the Banks and Trust Company Regulations Act of 1965.[42] Obviously, this type of provision tends to temper U.S. enthusiasm for making informational requests through the State Department. The Cayman Islands enacted identical legislation in the Banks and Trust Companies Regulation law of 1966. In 1976, the 5th Circuit held that foreign persons subpoenaed in the United States to give testimony before Federal grand juries must testify even though the testimony would violate the law in their own jurisdictions, *United States* v. *Field,* 532 F.2d 404 (5th Cir. 1976). This ruling arose from the IRS's controversial Project Haven which was designed to penetrate the Cayman Islands banking secrecy. In response, the Cayman Islands enacted the Confidential Relationships (Preservation) Law on September 8, 1976.[43] This law, designed to cure perceived shortcomings in the bank secrecy law, not only imposed criminal sanctions on those who divulge confidential information, but made it a felony to even attempt to obtain such information. The law is extraterritorial in application, and thus applies to any U.S. law enforcement agents who attempt to obtain confidential information.

A third common characteristic of tax havens is that banks and similar financial institutions assume a dominant role in the havens' trade and commerce, and those skilled in financial transactions, such as bankers, lawyers, and accountants constitute a large percentage of the haven's professional class. Banks and trust companies in the haven countries undoubtedly provide a vital economic service in facilitating complex multinational banking transactions. Indeed, many such countries aggressively compete with each other for American investments.

Growth:

A vivid example of the rapid growth of tax haven banks and trust companies is offered by the Cayman Islands. In 1964, the Caymans had only one or two banks and virtually no offshore (nonresident) business. When subcommittee staff members visited the Caymans in late 1981, the island had about 30 multinational full service "Type A" commercial banks and more than 300 "Type B" brass plate banks, which are allowed to conduct only offshore business. By 1983 Cayman was said to have 425 banks. Moreover, the number of offshore companies has jumped from about 15,000 in

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[42] See footnote 134, infra for a complete discussion of this act.
[43] See footnote 159, infra for a complete discussion of this law.

1981 to 36,000 in 1985. Yet, the population of the Cayman Islands is only 17,000.

In a statement for PSI hearings held on International Narcotics Trafficking in November 1981, Chief Counsel Weiland said that the Cayman Islands "provide an outstanding opportunity for individuals seeking to launder or otherwise hide illegal profits. They are readily accessible by commercial and private airlines from the United States, provide all modern amenities, feature English as the national language, assure a politically stable governmental environment, and maintain strict bank secrecy requirements."[44] In fact, numerous criminal cases have shown that many of the thousands of Cayman-licensed corporations are used as fronts for illegal operations.

Caymanian officials point out, however, that the practice of licensing banks and registering companies is an extremely important source of revenue. In 1981, initial and annual licensing fees accounted for approximately 20 percent of the colony's budget. In the meantime, the Caymans have begun large-scale licensing of insurance companies and active solicitation of ship registrations. Thus, registration fees have kept pace with a galloping Cayman budget.

Fortunately, it appears that the recent tradition of conflict with the Caymans may be changing. In August, 1984, the United States and the Caymans reached an agreement with respect to the disclosure of records relating to drug transactions. This is seen by both U.S. and Cayman government authorities as a very important development.

The Bahamas has had a similar history of growth. There are about 200 U.S. bank branches located in the islands, comprising more than half of the approximately 350 banks and trust companies licensed to do business. Furthermore, there are about 30,000 registered trading companies in the Bahamas.

Regulation:

Havens are usually free from U.S.-type banking regulations such as: Reserve requirements, loan-to-asset ratios, or stringent capitalization requirements. In some locales, bank license applicants are not required to meet any net capital or asset requirements or demonstrate banking experience, probity, prior noncriminality, or legitimate banking intent. License application fees are frequently low. In a few jurisdictions, bank licenses have been granted without any authoritative governmental supervision and offshore companies are registered in blocks by local law firms.

In most jurisdictions, international banking is separated from local commercial banking through a range of permissible and nonpermissible functions. Banks enjoying "offshore" status are not allowed to engage in local commercial or private business. Hence, in most jurisdictions these banks are not subject to any form of audit. Indeed, in some offshore banking centers, the offshore banks have such a spotty reputation that the local commercial banks will not even grant them checking accounts.

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[44] "International Narcotics Trafficking," Hearings, Senate Committee on Governmental Affairs, Permanent Subcommittee on Investigations, 1981, at 630.

Corporate entities (registered companies and trusts) often enjoy privileges beyond capital, transaction, and beneficial ownership concealment. These may include, for example, absence of a disclosure requirement on ownership of a holding company, no required annual reporting of any kind, and no audits or disclosures of stock ownership, including transfers or dividends. In some jurisdictions, registered companies may also act as trust companies or finance companies—indeed, as banks themselves—and may act as mutual funds or as security investors or brokers without regulation from the host or "headquarter" country. Incorporation fees may be very low. Ownership quite often is held in the form of bearer shares. Furthermore, for purposes of back dating, one may buy "off the shelf", "matured" shell companies which have been preregistered. A Panamanian lawyer told the staff that his firm sold many such companies. It merely paid the annual fees on a few older shell companies until a buyer appeared in need of, for example, a company at least 5 years old. Hence, in the most extreme case a bank or registered company may have been legally established and may pay an annual fee, but there may be neither a public nor protected record of its existence, with only its agents attesting to its legal status.

For some bank customers, convenience and expertise are absolutely essential. They need facilities capable of handling large amounts of cash and of transferring funds electronically. The facility must be a reliable fiduciary and sometimes even capable of serving as a world-wide portfolio manager.

Language is also a source of investor concern. English, the accepted international business language, is either the native language or the common second language of the business sector in virtually all havens.

Fiscal Importance:

In legitimate, well developed international financial centers, the creation of an environment condusive to offshore banking has aided the growth and development of the host nation. The developmental advantages can be measured by the increase in employment opportunities available to nationals, a general increase in the local literacy rate, vastly increased business travel, and a growing international respectability for the financial center.

In direct contrast, some countries hold themselves out as "pure tax havens", and tend to remain less developed. Their economies are relatively undiversified and are strongly dependent on finding a specialized economic niche in order to survive. Firms coming into the havens often require expatriate managerial and technical personnel. (Generally, the local populace is not drawn into the newly established organization.) The host country may require expatriate personnel to have work permits as well as adequate resident, health and transportation facilities. But it may be local government convenience, subject to the winds of politics or even threats of extortion, which determines whether or not a bank will have the work permits of its expatriate managers renewed.

Different governments tend to be preoccupied with different havens. For example, France, Italy and Argentina are concerned today with jurisdictions offering haven to flight capital, i.e. to individuals violating currency control regulations. Israel is concerned with nations providing banking facilities for terrorist arms purchases. EEC countries are concerned with havens catering to industries illegally profiting by violating Common Market rules. The United States, unlike all but one or two other nations, tends to be primarily concerned with tax evasion, but also must deal with drug trafficking, organized crime, pornography, union racketeering, securities and commodities fraud, bank fraud, health care fraud, management theft, bribery payments, and myriad other onshore activities in which unreported profits are exported offshore to escape detection and successful prosecution.

Thus, strictly in utilitarian terms, a tax haven can be defined as any jurisdiction which provides accessible facilities, together with an infrastructure, and socio-political milieu, that are more lucrative (because of secrecy and tax breaks) than those available in financial communities of other jurisdictions.

Given these variations and their preconditions, those havens which are of concern to law enforcement authorities do have elements in common. How a jurisdiction goes about securing offshore business which, in one or another foreign country has illegal aspects, depends on the location, morals and integrity of that host country. A haven country competes economically by attracting foreign investment to utilize its banking facilities and to form offshore companies. It intends, through law and practice, to protect the investments and the investors from harm or loss inflicted by any foreign country of which these investors are residents or citizens, or in which they are economically active.

This is not to say that any haven which exploits a competitive advantage over a neighbor country is necessarily immoral. The Swiss secrecy law was enacted in response to actions by the German Nazi government seeking to acquire the assets of fleeing or holocaust-annihilated Jews. Few would not applaud this Swiss response. Moreover, the common law precedent which underlies British Commonwealth banks secrecy, *Tournier* v. *National Provincial and Union Bank of England,* 1 K.B. 461 (1924), concerns the duty of a banker to treat his customers' financial affairs as confidential; a duty readily recognized throughout the world.

HAVEN NUMBERS

Estimates on the number of tax havens vary widely depending on the definition applied and the country from which the tax haven is viewed. A particular jurisdiction may have a whole panoply of taxes but offer a particular tax incentive which results in it being considered a "tax haven" for that one purpose.

In a November 1981 letter to the Chairman, IRS Commissioner Roscoe L. Egger listed 29 "havens":

LIST OF TAX HAVEN AREAS

1. Antigua
2. Austria
3. Bahamas
4. Bahrain
5. Barbados
6. Belize
7. Bermuda
8. British Virgin Islands
9. Cayman Islands
10. Costa Rica
11. Channel Islands
12. Gibraltar

13. Grenada
14. Hong Kong
15. Isle of Man
16. Liberia
17. Liechtenstein
18. Luxembourg
19. Monaco
20. Nauru
21. The Netherlands
22. The Netherlands Antilles
23. New Hebrides
24. Panama
25. Singapore
26. St. Kitts
27. St. Vincent
28. Switzerland
29. Turks and Caicos Islands

Obviously, the Caribbean boasts a large number of havens, particularly in relation to the U.S. markets. Within the arc extending from Bermuda southward and eastward to the Cayman Islands, lie numerous British common law countries or colonies that are regarded as tax havens. They impose little or no income or capital gains or other taxes, and their laws are designed to encourage offshore investments and deposits. Other jurisdictions in the area, such as Jamaica and Trinidad and Tobago, aggressively seek foreign investment. But these do not compete for offshore banks, insurance companies, or trust funds by offering tax incentives or other vehicles by which foreigners avoid taxation in their native countries.

The WFI Corporation, which sells offshore banks, cited Canada, Guam, Ireland, Mexico, Cook Islands, and the Maldive Islands as key sites in a list distributed at its spring 1982 seminar. An April 28, 1982, WFI announcement described the Mariana Islands as a new tax haven, one created at the urging of WFI and after the Mariana Islands achieved self-governing U.S. commonwealth status. Through a comparison of certain elements of a group of havens, such as the infrastructure, political stability, taxation, costs of bank establishment and secrecy laws, WFI concluded that the Marianas was the best haven for bank purchases, with Vanuatu as the second choice. Previously, WFI had touted Montserrat as the best haven. However, in interviews with the PSI staff, the government of Montserrat indicated it now insists on dealing directly with prospective bankers and no longer allows WFI to broker Montserratian banks. WFI then shifted its emphasis to the Northern Marianas, apparently based upon informal inroads it had made with some segments of the local government. In any case, it is clear from the testimony of WFI's president at the subcommittee's hearings that a haven's popularity can be fleeting.

Finally, with the 1981 revision of Federal Reserve regulations creating International Banking Facilities (IBFs), the United States has clearly strengthened its own position as an offshore "tax haven," albeit one with some restrictions and without substantial secrecy protection.

From this, several principles become evident:

> (a) The definition of a haven depends on the criteria used which in turn tends to relate to considerations such as user advantage and disadvantage.
>
> (b) Haven status changes rapidly depending upon political events as well as shifts in local law or treaties in force. Expert lists will disagree depending upon when they are completed and what judgmental criteria are employed.
>
> (c) Once a particular interest is enunciated—for example, a concern with offshore-aided violations of U.S. crimi-

nal law—it is necessary to generate a separate "catalogue" of havens on the kinds of criminal uses made of a jurisdiction. Specific characteristics which serve as incentives to those criminal uses and the specific problems posed to U.S. law enforcement authorities as they seek to detect and prosecute the underlying crimes need to be considered separately.

Given the diversity among havens, it would be extremely helpful to know their relative importance in terms of criminal use. The IRS' Gordon Report attempted to rank their importance using a functional measure of foreign assets held by the haven. Although the approach is logical it tends to be an inadequate guideline for our purposes. It would be far more helpful to utilize a pragmatic approach by arriving at an estimate for the amount of dirty money being laundered through a jurisdiction.

However, because of the element critical to the U.S. criminal law violators, the assurance of secrecy, it is not possible to quantify such criminal uses. Any such ranking can be derived by estimates based on confidences offered by U.S. authorities or foreign authorities or bankers, or by examining criminal and civil cases which have become public knowledge, or finally, by extrapolating it from the minimal data actually available such as Treasury Department currency transaction reports and repatriation figures. Unfortunately, none of these options is very reliable but patterns do emerge and will be discussed in this report.

SIZE OF HAVEN BANKING SYSTEMS

As originally conceived, this report was to contain a section comparing the relative sizes of offshore banking systems for several jurisdictions. The computation to be used was the foreign assets and liabilities (bank and non-bank, financial sector) as a percentage of the country's total assets and liabilities, as well as a percentage of domestic assets and liabilities; and the GDP of each country was to be used as a base to assess the amount of a country's income that arose from purely financial transactions. The intent had been to compare the international size of countries in relative terms, and to assess how much of each country's financial sector was international, rather than domestic in nature.

Once the specific formulas and format had been ascertained, PSI staff met with officials at the IMF, IRS and FRB to obtain the data necessary to produce a meaningful study. Unfortunately, all three institutions indicated that such a study would be time consuming, arduous and not very reliable because: (1) there is a distinct lack of financial information from many countries; (2) information that is provided on numerous countries from various sources is not standardized; (3) there is a discrepancy between available figures as to whether they reflect only banks or all financial institutions; and (4) U.S. institutions lack data on the number of dollars going in and out of banks—the money transactions or turnover of dollars which show how much of a demand for money there is in the economy.

Thus, a composite comparison is not possible and one is left with merely broad based estimates of relative size. For example, an interviewer hears that the Bahamian banking system is far larger than that in the Cayman Islands and probably substantially larger than Panama. The Swiss system is doubtless larger than all three. But further quantification is impossible and just where the banking systems of havens such as Hong Kong, Singapore, Bahrain, and Barbados fit in defies calculation.

V. INTERNATIONAL BANKING SUPERVISION AND BANKING DILIGENCE

With the rapidly increasing volume of international money laundering and the growing number of bank scandals involving international transactions,[45] the need for international banking guidelines and supervision has increased dramatically.

There are three basic areas in which banking supervision can be applied to offshore and international banking facilities: (1) local supervision by the banking regulatory/supervisory authority of the host country; (2) central bank supervision in the home country of the parent bank; and (3) supervision of branch activities by the headquarters of the parent bank. In some cases there may be a philosophical conflict over primacy of home versus host country bank controls, but even if such a conflict were to occur, it would more than likely involve a major Eurobank located in an international financial center, such as a Swiss branch in New York City. In the case of a haven country, its central banking controls will probably not be as strict as those of the major trading nations. Indeed, in many havens the only control over banking is that which is exercised from the home country. Therefore, what is needed more than ever, is international cooperation among bank regulatory authorities.

INTERNATIONAL BANKING SUPERVISION

Bank supervisory authorities have been aware of the growing need for international supervisory guidelines and cooperation for more than a decade. In 1972 the first formative step to bring together bank supervisors was taken when the Groupe de Contact met in the United Kingdom. The purpose of the conference was to achieve closer understanding and practical cooperation between banking supervisors of member States.

The Groupe de Contact was the forerunner of the Basel Committee of Supervisors, also known as the Cook Commission. The committee's initial meeting occurred in February 1975, and thereafter it has met at least three times a year.[46]

Upon its formation, the committee perceived two major tasks before the international banking community: (1) The need to adopt a national supervisory system within each country in order to cope with the ever widening dimensions of their banking business; and (2) the promotion of closer cooperation between national authorities in monitoring the activities of the overseas branches, subsidiaries and affiliates of their own banks, in addition to the offshoots of foreign banks located within their territories.[47]

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[45] For example, in the *Credit Suisse (Chaisso)* case the transactions were Italian-Swiss-Liechtenstein; in the *Franklin National Bank of New York* case, the transactions were U.S.-Swiss-Italian; and Banco Ambrosiano involved Italian-Luxenbourgian-Panamanian transactions.

[46] W.P. Cooke and R.M.G. Brown, "Developments in Cooperation Among Banking Supervisory Authorities", *Bank of England, Quarterly Bulletin*, Vol. 21, No. 2 (June 1981), p. 239.

The Basel Committee concentrated its efforts on carving out the first principles for international supervisory cooperation. Its first priority was to attain an appropriate division of responsibility among national authorities for the supervision of a bank's foreign establishment, and ensure that no foreign banking establishment escaped supervision. The committee's second concern was to establish an early warning system to protect national banking systems from potential problems. Here the committee concluded that because of differences in national banking and legislation systems, the institutionalization of an international supervisory organization would result in a duplication of national bank monitoring arrangements. Thus, the committee decided that any actions to counter a potentially dangerous situation should be taken by the national supervisory authorities in the jurisdiction in which it occurs. Any other countries affected by the danger are to be consulted as deemed appropriate. In addition, the committee recommended bank supervision on a consolidated basis, whereby the capitalization and risk exposure of international banks would be monitored on the basis of their worldwide business. This recommendation arose from Germany's Herstatt Bank's foreign exchange crisis in 1974.[48]

The signing of the 1975 Basle Concordat by the members of the Basel Committee marked the first and most significant step forward in cooperative international banking supervision. The Concordat establishes the guidelines and the responsibilities of supervisory authorities with facilities located in more than one jurisdiction. The Concordat encompasses the following principle guidelines and recommendations:[49]

* The supervision of foreign banking establishments should be the joint responsibility of host and parent authorities.

* No foreign banking establishment should escape supervision, each country should ensure that foreign banking establishments are supervised, and supervision should be adequate as judged by both host and parent authorities.

* The supervision of liquidity should be the primary responsibility of host authorities since foreign establishments generally have to conform to local practices for their liquidity management and must comply with local regulations.

* The supervision of solvency of foreign branches should be essentially a matter for the parent authority. In the case of subsidiaries, while primary responsibility lies with the host authority, parent authorities should take account of the exposure of their domestic banks' foreign subsidiaries and joint ventures because of the parent bank's moral commitment in this regard.

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[47] Ibid.
[48] Ibid.
[49] Ibid.

> * Practical cooperation would be facilitated by transfers of information between host and parent authorities and by the granting of permission for inspections by or on behalf of parent authorities on the territory of the host authority. Every effort should be made to remove any legal restraints (particularly in the field of professional secrecy or national sovereignty) which might hinder these forms of cooperation.

The Concordat is not, and never was intended to be, an agreement about the "lender of last resort" responsibilities to the international banking system.

It should also be stressed that the Concordat's guidelines have not been fully implemented in practice and certainly not in law. There are still areas where the division of supervisory responsibility is not entirely clear and where bank secrecy provisions are an impediment to its effectiveness. In addition, the 1975 Concordat suffered from three basic weaknesses:

1. The danger that a host country would look to a foreign bank's headquarters jurisdiction to supervise local branches under the principle of consolidated supervision, while headquarters authorities would rely on host countries;
2. The failure to address the question of differing supervisory standards; and
3. The widespread but mistaken belief among commerical bankers that the supervisory and lender of last resort responsibilities of national authorities necessarily went hand-in-hand.[50]

The collapse of Banco Ambrosiano in August 1982—shortly after it was discovered that the bank's late chairman, Roberto Calvi, had channeled $1.3 billion to dummy Panamanian companies[51]—graphically illustrated the weaknesses of the 1975 Concordat and international banking supervision.

The "lender-of-last resort" principle was a central issue with the collapse of Banco Ambrosiano. Domestic and foreign creditors of the parent bank in Milan were paid back through the intervention of Italy's central bank. However, creditors of the bank's Luxembourg unit, Banco Ambrosiano Holding, were told that the unit was outside of Italy's jurisdiction. In response, the more than 200 creditors of Ambrosiano's Luxembourg holding company stated that, "by the time honored, unwritten rules of the Euromarket, they had every right to expect the same treatment as a creditor of the Milan parent bank, particularly since the Luxembourg holding company's name—Banco Ambrosiano Holding, S.A.—explicitly linked it with the parent."[52] However, because Banco Ambrosiano Holding was not a wholly owned subsidiary and the 1975 Basel Concordat was vague as to who was responsible for overseeing foreign holding companies, neither the Luxembourg nor Italian banking authorities were empowered to supervise it. Thus, both authorities disclaimed responsibility for providing lender of last resort assistance to the Luxembourg entity.[53] In addition, Italian officials noted that Mr. Calvi had often brushed off prying bank inspectors by claiming protection under the bank secrecy laws of "offshore" financial centers, such as Luxembourg and the Bahamas, where the bank conducted much of its business.[54]

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[50] Ibid., at p. 240.

[51] Richard Dale, "Basle Concordat: Lessons From Ambrosiano," *The Banker*, September 1983, pp. 56–57.

[52] Peter Truell and Roger Cohen, "Ambrosiano's Major Creditors Near Pact On Claims Against Unit of Italian Bank," *The Wall Street Journal*, February 17, 1984, p. 35.

These companies were owned directly or indirectly by the Vatican bank, Instituto per le Opere e Regilione.

In May 1983, the 1975 Basel Concordat was superceded by the Cooke Committee's "Principles for the Supervision of Banks Foreign Establishment." The statement, in addition to reformulating and elaborating on the 1975 guidelines, adds the concept of bank supervision on a consolidated basis. In other words, an evaluation of a bank's total capital adequacy and risk exposure is to be based on the assets and liabilities of the bank's parent offices, foreign branches, subsidiaries and affiliates. Thus, the new approach to supervisory responsibilities rests on the assumption that the solvency of a foreign branch is indistinguishable from that of the parent bank.

The 1983 statement specifically notes: (1) its concern with the supervision of international banking, and not the lender of last resort function of central banks; and (2) that the guidelines provided in the statement are goals toward which members have agreed to work, but are not presently implemented in the laws of all member countries.

The 1983 statement cites two basic principals as being fundamental to international supervisory cooperation: (1) no foreign banking establishment should escape supervision; and (2) supervision should be adequate. Yet, despite the strengthening of international banking supervisory guidelines, problems may continue to arise: [55]

> 1. When a foreign establishment is classified as a bank by its parent banking supervisory authority, but not by its host authority;
> 2. Where gaps in supervision occur because of the structural features of international banking groups; and
> 3. Where the host authority considers the supervision of the foreign bank's parent inadequate or nonexistent; [56] or
> 4. Where the host authority's supervision is inadequate.[57]

In summary, the principle of adequate bank supervision requires the positive participation of both the host and parent authority. Unfortunately the cooperation necessary is not always forthcoming, which leaves international banking supervision replete with loopholes for money launderers and other tax evaders.

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[53] ————, "Ambrosiano's Fallout on International Banking," *The Wall Street Journal"* September 1, 1982.

[54] Ibid. See also, "Milan Mystery: How the June Suicide of Ambrosiano's Chief Exposed a Murky Maze," *The Wall Street Journal,* August 30, 1982.

[55] Committee on Banking Regulations and Supervisory Practices, "Principles for the Supervision of Banks' Foreign Establishments," Basle, May 1983.

[56] In this case the host authority should discourage or forbid the operation of the bank within its territory.

[57] In this case the parent authority should extend its supervision.

SWISS BANKING DILIGENCE

What about the rules banks set for knowing new customers, such as the "diligence" practiced by the Swiss and, to an increasing extent, gradually the Bahamians?

The Swiss "Convention on the need for caution when accepting deposits and on the use of banking secrecy" was born in the aftermath of the 1977 Credit Suisse scandal, when its Chaisso branch was soliciting deposits from abroad without bothering to find out who its customers were.[58]

Originally signed June 1, 1977, the Convention—a mere two page document—is a private agreement between the Swiss National Bank and the Swiss Bankers Association. It requires bankers "not to open bank accounts and securities deposits, not to provide safe-deposit facilities unless they have ascertained with such care as, according to circumstances, can reasonably be expected who the beneficial owner is." [59] Thus, a rigorous background check is supposedly conducted on the person contracting with the bank, and also on the beneficiary. In the case of a domicilary account, the banker must look into the people who "control" the company economically, i.e., "the person or group of persons who directly or indirectly have more than half the share capital or voting capital or who exercise a controlling influence in a recognizable manner." [60] The original term of the Convention expired in 1982, with an amended version being adopted in October 1982 and due to expire in 1987.

So what is the apex of the Convention and why is it structured the way it is?

> The point is political: The Convention contains obligations which are in general rather greater than those which a State would enter into unilaterally with one or more other States. It was imperative that the Swiss government would not find its hands tied in some future negotiations and could even receive unofficial help from the bankers who could threaten not to renew the Convention: Its existence could then become useful as a negotiating weapon.[61]

In 1982, the Convention on diligence was extended to include clients seeking to carry out over-the-counter cash transactions for amounts exceeding 500,000 Swiss Francs. The revision also only provides Swiss lawyers and members of the Swiss associations of trustees and auditors with the privilege of invoking professional secrecy to get out of registering their clients' names. However, to claim this secrecy right, they must declare that they know their client personally and that they are not aware of any circumstances that could lead to an abuse of banking secrecy. Thus, the edifice rests on the integrity of the lawyer or trustee—a loophole that the Swiss National Bank (SNB) would like to see closed.[62]

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[58] Business Brief, Economist, July 16, 1983, p. 70.

[59] Ibid., pp. 70–71.

[60] Edouard Chambost, "Bank Accounts: A World Guide to Confidentiality" (John Wiley & Sons, Ltd. 1983), pp. 35–36.

[61] Ibid.

Under the current rules of the Convention, only the banks—and not the individual bankers—can be punished for an infringement. The SNB would like to make individuals liable as well as the banks themselves.

Since 1977, 30 cases against the Convention have been heard. These infringements upon the diligence code have been dealt with discretely. Even when the banks involved have been found guilty and fined, their names have never been published.

The Swiss National Bank, the Federal Department of Finance, and the Swiss bankers themselves claim the Convention as a certificate of morality, and that no further restrictions need be added to the banking industry.[63]

BAHAMA BANKING DILIGENCE

While the Bahamas' Central Bank ostensibly supervises local banks licensed in the Bahamas fairly actively, it looks to the home jurisdiction of parent banks to supervise their offshore branches located in the Bahamas. The Bahamas has a very active Association of International Banks and Trust Companies (AIBT) which consists of about 100 member organizations. The AIBT works closely with the Central Bank and with the Bahamian Institute of Bankers to promote banking in the Bahamas. A major step to curb "suitcase currency" was recently taken by the Central Bank and supported by the AIBT. On August 11, 1983, the Governor of the Central Bank of the Bahamas indicated that he had decided to restrict the acceptance of cash deposits by banks established in Nassau and, as a first step, he had instructed the Clearing Bank Association accordingly. The substance of this action is set out in an August 15, 1983 memorandum to AIBT members.

MEMORANDUM TO ALL MEMBERS

During a meeting which took place at his request on August 15, 1983, the Governor of the Central Bank of The Bahamas indicated that he had decided to restrict the acceptance of cash deposits by banks established in Nassau and that as a first step he had instructed the Clearing Bank Association accordingly.

The above measures described in paragraphs 1, 2, 3 and 4 take effect as from the date of this memorandum.

In view of the sensitive and important issue we are dealing with, may I kindly ask all members to actively support the Central Bank's efforts by strictly following the described procedure.

Your understanding and co-operation are very much appreciated and will, no doubt, contribute to improve the image of the Bahamas, as a properly self-regulated international banking and investment centre.

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[62] Business Brief, pp. 70–71.

[63] Ibid., p. 70.

The Governor knows that members of AIBT are much less involved in such transactions. However, he wishes members of AIBT to follow the same approach and procedure:

1. Large cash deposits are not welcomed in the Bahamas, especially if they are attempted to be made by physical persons or corporations who do not have an existing relationship with the member involved.

In essence, such transactions emanating from unknown parties could be classified as helping, protecting, or covering up criminal activities of any kind.

2. Institutions should only deal with clients who have an existing relationship or who have formally established their credentials or are recommended by reputable parties including, for example, other banks, trust companies, law firms, accounting firms and other professionals.

3. "Large Cash Deposits".

The Governor does not wish to be too specific, for the time being and take formal measures which could harm legitimate business. He would prefer to leave the decision upon the individual AIBT member, who should then exercise both common sense and professional judgment in accepting cash deposits.

However, the Governor feels that cash transactions in excess of U.S. $100,000 should be defined as "Large Cash Deposits" and that caution should be exercised before accepting them.

For your information, some Clearing Banks have defined amounts in excess of U.S. $5,000 as "Large Cash Transactions".

4. Reporting to the Central Bank of the Bahamas of Cash Transactions.

During the trial period, attempts to make large cash deposits should be reported to the Governor's office in the following manner:

4.1 Immediate reporting by telephone, confirmed by letter with:

4.2 Details of the party attempting to deposit the funds as they appear from a photocopy to be made of either and/or passport, driving license, identity card, cedula (for Latin American countries): Name, first name, date and place of birth, where, when and by whom document issued, permanent address as well as temporary address in Nassau should be noted.

4.3 Amount of transaction proposed.

In a further step, the Board of the AIBT adopted a Code of Conduct in early 1984, which among other things, requires members to know their customers. Part II of the Code states "Members shall take all reasonable measures to determine the identity of the beneficial owners of all accounts (including the controlling beneficial shareholders of companies), and will not open accounts unless they have determined such identity and have obtained proper references. Members shall not accept accounts represented by a third party acting as power of attorney unless such identity is known." [64]

In addition to the government imposed regulations of Switzerland and the Bahamas, numerous banks of various countries practice forms of diligence independent of government regulation. For example, new deposits by a company may be subject to screening according to the bank's self-imposed rules. Typically, a bank may require a city license, State sales tax permit, or newspaper legal announcement when doing business with a company. Realistically, however, such requirements cannot assist a bank in identifying legitimate enterprises used for laundering.

For out-of-State depositors, prudent banks can follow the same practice that some careful, reputable offshore banks employ with strangers: funds are accepted and held in safe-keeping but no regular account is opened until a credit check is forthcoming. Offshore, a reputable bank may make inquiries of the U.S. Comptroller of the Currency or request the Federal Reserve to check on the banknote numbers of cash presented. In the United States, a typical device is a query to a credit bureau in the last residence of the account applicant.

While "diligence" may be practiced by some banking institutions, others rely upon "bankers' discretion". Such discretionary services may include: Allowing clients with unverified identities to make deposits; allowing clients whose funds are not of foreign origin to make investments, or to transmit funds, on behalf of foreign registered companies; or to allow local companies themselves to act as laundries. In the United States itself, bankers' abuse of discretion might be said to include the failure to file tax information returns on overseas earnings as well as the willing participation in sequential transactions just under the Treasury reporting thresholds and currency and monetary instruments.

VI. BLOCKING AND SECRECY LAWS

Non-disclosure laws fall into two categories: Secrecy and blocking provisions. Secrecy laws usually involve general confidentiality. They prohibit the disclosure of business records and/or the identity of bank customers to a third party. Blocking laws, on the other hand, are very specific in nature. They prohibit the disclosure, copying, inspection or removal of documents located in the territory of the enacting State in compliance with the production orders of a foreign authority. Intended to protect the general economic and business interests of the enacting jurisdiction, blocking statutes are occasionally imposed on a particular industry.[65]

Currently there are more than 15 jurisdictions with secrecy laws and 16 jurisdictions with blocking laws, all of which have access to the U.S. markets.[66] Since 1975, several of these laws have been promulgated in direct response to the alleged or actual extraterritorial application of U.S. laws.[67]

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[64] ———, "Bad Trip", *Economist*, May 5, 1984, p. 89.

[65] Testimony of John M. Fedders, Director of Division of Enforcement, SEC, PSI Hearings,"*Crime & Secrecy: The Use of Offshore Banks and Companies,*" (98th Congress, 1983) p. 339.

[66] Prepared Statement of John M. Fedders, SEC, PSI Hearings, *"Crime & Secrecy,"* pp. 318-332.

1976 Australia, Foreign Proceedings (Prohibition of Certain Evidence) Act
1976 Canada, Uranium Information Security Regulations
1978 South Africa, Protection of Business Act
1980 France, Law Relating to the Communication of Economic, Commercial, Industrial, Financial, or Technical documents or Information to Foreign National or Legal Persons
1980 United Kingdom, Protection of Trading Interests Act

The codification and enforcement of non-disclosure laws is part of a much larger conflict between United States' legal and enforcement policies and the policies promoted by the non-disclosure jurisdictions. To date, the United States has been unable to resolve the most important underlying cause of this conflict—a difference in pretrial discovery practices.

American pretrial discovery rules are far more liberal than their foreign counterparts. Under U.S. law, a court is permitted to order the production of documents that are inadmissible at a trial as long as the documents sought appear "reasonably calculated to lead to the discovery of admissible evidence".[68] Most common-law and civil law jurisdictions condemn such pre-trial investigations as "fishing expeditions", permitting only the production of evidence that would be admissible at trial and allowing for the disclosure of evidence sought by letters rogatory for criminal matters only after "commencement" of the proceedings, which has come to mean the issuance of an indictment.[69]

According to the SEC and many practitioners, the legislative history of many of the foreign blocking laws indicates they were enacted in response to problems allegedly encountered by local industry and commerce as a result of U.S. litigation, notably in the anti-trust field. Many countries feel that the extraterritorial application of U.S. discovery procedures in anti-trust and similar cases is disruptive and designed to protect American industry from foreign competition. Liberal pretrial discovery procedures are, indeed, burdensome and engender strong reactions from foreign companies and individuals who are asked to disclose information which would be to their U.S. competitors advantage.[70]

Despite the existence of non-disclosure laws, U.S. courts are still technically permitted to compel the production of documents under the conflict of laws principal *lex fori*—the law of the forum governs procedural matters—although production and discovery orders continue to be limited by the principle of international comity. In any event, U.S. courts have had difficulty acquiring information, because some jurisdictions consider American production orders to be an infringement on their sovereignty. A few countries have even filed diplomatic protests with the U.S. State Department over U.S. discovery requests.[71]

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[67] Thomas Scott Murley, "Compelling Production of Document in Violation of Foreign Law: An Examination and Reevaluation of the American Position," "*Fordham Law Review,*" Vol. L. (1981–1982), p. 880.

[68] 28 USC Section 26(b)(1).

[69] Op. Cit. note 67, pp. 885–886.

[70] PSI Hearings, p. 14. Indeed, the American Bar Association devoted a two-day seminar to this topic in 1984. "Transnational Litigation: Practical Approaches to Conflicts and Accommodations," ABA National Institute, Washington, D.C. March 8–9, 1984.

A common strategy of a non-disclosing foreign party attempting to justify its position is the invocation of Section 40 of the Restatement (2nd) of Foreign Relations Law of the United States (1965), which provides:

> Where two States have jurisdiction to prescribe and enforce rules of law and the rules they may prescribe require inconsistent conduct upon the part of a person, each State is required by international law to consider, in good faith, moderating the exercise of its enforcement jurisdiction in the light of such factors as: (a) vital national interests of each of the States; (b) the extent and the nature of the hardship that inconsistent enforcement actions would impose upon the person; (c) the extent to which the required conduct is to take place in the territory of the other State; (d) the nationality of the person; and (e) the extent which enforcement by action of either State could reasonably be expected to achieve compliance with the rule prescribed by that State.

Two of the most common defenses used by non-disclosing parties are predicated on the provisions of Section 40: (1) disclosure by the foreign party will violate the law of its own country and may be accompanied by criminal sanctions, and (2) foreign governments have a strong commercial interest in protecting their domestic corporations from the expense and hazards of defending American litigation.[72]

The protection of an individual from inconsistent law enforcement actions, and the weighing and balancing of national interests have always been at the forefront of U.S. international evidence production. Unfortunately, the means employed by many jurisdictions to protect their commercial interests—threatening to punish those who give evidence—runs counter to the basic premise of the U.S. judicial system. As a result, the question of which nation has more at stake in the production of evidence is becoming more crucial. In several recent court cases, including *U.S.* v. *Field,* and *U.S.* v. *Bank of Nova Scotia,* the holdings were that the economic and judicial concerns of the U.S. would be in jeopardy if the non-production of foreign evidence was permitted. Therefore, it was held that U.S. national interests should prevail over the concerns of the individuals and other jurisdictions involved, and production by the non-disclosing defendant was required.

Another very compelling rebuttal for the U.S. courts when a defense is predicated on Section 40 applies in a situation where the non-disclosing defendant itself bears responsibility for the enactment of the concealment legislation.[73]

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[71] Op. Cit. note 67, pp. 881, 885–886. The international furor that can be caused by enforcement of U.S. discovery orders is demonstrated in such cases as *Toyota* (C.D. Cal. 1983) and the *Laker Airline Case,* (D.C. Cir. 1984).

[72] Paul A. Batista, "Confronting Foreign 'Blocking' Legislation: A Guide to Securing Disclosure from Non-resident Parties to American Litigation," The International Lawyer, vol. 17, No. 1 (Winter 1980), p. 80.

[73] Ibid., p. 82.

The Restatement (2nd) is the balancing concept generally accepted by the U.S. judicial system. However, in the recent case *U.S.* v. *Toyota,* 569 F. Supp. 1138 (C.D. Cal. 1983), the court adopted the Restatement (Revised) tentative draft no. 3 1982. In the Restatement (Revised), Section 420 speaks more directly about the issue of extraterritorial discovery than the 2nd Restatement providing:

> If disclosure of information located outside the United States is prohibited by a law or regulation of the State in which the information or prospective witness is located, or by the State of nationality of the prospective witness,
>
> (a) the person to whom the order is directed may be required by the court to make a good faith effort to secure permission from the foreign authorities to make the information available;
>
> (b) the court may not ordinarily impose the sanction of contempt, dismissal, or default on the party that has failed to comply with the order for production, except in cases of deliberate concealment or removal of information or of failure to make a good faith effort in accordance with paragraph (a);
>
> (c) the court may, in appropriate cases, make findings of fact adverse to a party that has failed to comply with the order for production, even if that party has made a good faith effort to secure permission from the foreign authorities to make the information available and that effort has been unsuccessful.

[The remainder of this section will provide a brief overview of several different blocking and secrecy laws. This discussion is not necessarily a comprehensive review of all of the non-disclosure laws of any one jurisdiction, let alone all non-disclosure laws generally.]

FRANCE

On July 16, 1980, the French blocking statute entitled "Law Concerning The Communication of Documents or Information of an Economic, Commercial, Industrial, Financial or Technical Nature to Aliens, Whether Natural or Artificial Persons" was enacted. The statute contains four sections. The first declares it unlawful, with certain qualifications, for a French national to disclose to a foreign entity any information which might impair France's sovereignty, security, or its "basic economic interests". Article 1(a) declares it unlawful for anyone, including an American litigant, to seek disclosure from French sources other than through means prescribed by French law. Article 2 requires any person within the scope of Article 1 and 1(a) to notify the "competent" French minister of any request for information, including the service on a French party involved in U.S. litigation of interrogatories, document demands or deposition notices. Finally, Article 3 purports to impose criminal sanctions which would apply to a violation of the legislation.[74]

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[74] Ibid., pp. 64–65. Article 3 purports to impose criminal sanctions which would apply to a violation of the legislation: "Without prejudice to more serious penalties provided by law, any

Continued

The legislative history of the blocking statute discloses that the law was clearly designed as an effort to preclude pretrial discovery of French nationals involved as parties in American litigation. Report No. 1814 of the French National Assembly dated June 19, 1980 (the Report), which explains the background, purpose and intended impact of the blocking statute, is premised on the French perception of the "abuse" inherent in all pretrial discovery in American courts. The report is candid in its articulation of the purpose of the blocking statute to immunize French corporations from the need to comply with discovery obligations in American courts.[75]

UNITED KINGDOM

The adoption of the "Protection of Trading Interests Act" by the British followed the enactment of the French act by only months. The legislation was designed to "provide protection from requirements, prohibitions, and judgments imposed or given under laws of countries outside the United Kingdom and affecting the trading or other interests of persons in the United Kingdom."[76] The scope of the United Kingdom's act is much broader than that of the French. However, the act does contain a discovery related provision.

The discovery provision grants the British Secretary of State the ability to prohibit persons or corporations in the United Kingdom from furnishing commercial information or producing commercial documents for use in a foreign country. Broad discretionary authority is accorded to the Secretary of State to provide a British entity with immunity from disclosure. The power to preclude compliance with U.S. discovery orders or requests is so expansive that the Secretary of State can overrule compliance with any pretrial device solely on the grounds that it is a "pretrial disclosure" device. Moreover, in adopting the Hague Convention, Britain also implemented the reservation under Article 23 which excludes from the scope of the treaty letters of request involving pretrial discovery of documents.[77]

SWITZERLAND

As already noted, Swiss secrecy laws were originally adopted during the 1930's in response to Nazi Germany's efforts to uncover information for use against its own citizens as well as Swiss residents. The scope of Swiss banking secrecy is defined in the Swiss civil code as part of each individual's right to privacy, and in each contract between the bank and the bank customer. Enacted in 1934, SBA Article 47 prohibits the disclosure of customer transactions, and of bank communications with its customers and others regarding those transactions. Sanctions are applicable to those individuals who infringe upon these secrecy rights directly, or induce or try to induce others to break the confidence, and to those who

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violations of articles 1 and 1(a) of this law shall be punishable by two to six months' imprisonment and a fine of from 10,000 to 120,000 francs ($2,500 to $30,000) or either one of these two penalties alone."

[75] Ibid., p. 65.

[76] Ibid., p. 69.

[77] Ibid., pp. 69–70.

violate the act through negligence.[78] Switzerland is an example of a country in which a violation of banking secrecy is a criminal as well as civil offense.[79]

Switzerland's bank secrecy laws are founded primarily in private law. In Switzerland, public law preempts private law. Thus, secrecy can not be asserted where public law requires disclosure of particular information.[80] Under Swiss law, two circumstances may relieve a bank of its obligation to preserve customer confidences: (1) the customer's voluntary consent to disclose; and (2) a directive by competent Swiss authorities (such as court order) to disclose.[81]

Swiss private law gives the bank customers, and not the bank, control of the banking secret. Thus, the bank customer, subject to certain exceptions, may voluntarily waive his banking secrecy protections and direct the bank to disclose any information regarding his account to the government or any other third parties.[82]

Within the past 10 years several developments have tempered Swiss secrecy laws:

1977 U.S.-Swiss Treaty Mutual Assistance in Criminal Matters (signed in 1973)
982 Memorandum of Understanding (MOU) and Convention XVI
1983 Law on International Mutual Legal Assistance on Criminal Matters (MAA) or (IMAC)
1984 Insider dealing became a criminal offense in Switzerland

The MOU between the United States and Switzerland essentially confirms and supplements the U.S.-Swiss Treaty of 1977. Through its Convention,[83] the MOU effectively guaranteed Swiss cooperation in SEC investigations despite the absence of criminal sanctions in Switzerland. The U.S.-SEC considered this understanding to be a landmark agreement, because Convention XVI afforded the SEC with Swiss assistance in tracking down inside traders using Swiss security traders to make their transactions on the U.S. securities exchange.

Under the MOU, the Swiss permit and assist in SEC investigations as long as the requirements of the 1977 Treaty are met, and the investigations relate to conduct which might be dealt with by criminal courts. The agreement also resolves the problem of mutuality of criminal offenses: That an offense has to be criminal in both the United States and Switzerland to be investigated.[84]

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[78] ———,"Taking the Secret out of Swiss Banking," The Economist, July 16, 1983, p. 70.

[79] George Friedli, "New Law Helps Lift Veil of Secrecy from Swiss Banking," Legal Times, December 5, 1983, p. 7.

[80] See Raifman, "The Effect of the U.S.-Swiss Agreement on Swiss Banking Secrecy and Insider Trading", Law and Policy in International Business, Vol. 15, No. 2 (1983), p. 575.

[81] Op. Cit., Note 79, Friedli, p. 8.

[82] Op. Cit. Raifman, pp. 575–576.

[83] Convention XVI creates a mechanism for Swiss banks to provide information to the SEC in cases not covered by the Treaty which involve possible insider trading. Commission requests for information will be made through the U.S. Department of Justice and the Swiss Federal Office for the Police Matters to a three-member Commission of Inquiry (COI) appointed by the Swiss Bankers' Association.

[84] Unfortunately the MOU suffers several weaknesses. First, it is not a binding instrument subject to ratification. Second, it only deals with a particular subclass of insider trading: insider traders involved in business combinations and acquisitions of more than 10% of the securities of an issuer by an open market purchase. And, third, its inability to address other SEC violations, which will surely result in future conflicts between the U.S. and Swiss secrecy laws.

On January 1, 1984, Convention XVI of the MOU was terminated by the enactment of a Swiss penal code concerning the "misuse of material non-public information." Customers placing orders on the U.S. stockmarket are now automatically required to waive their secrecy rights, and insider trading is considered to be a criminal offense under Swiss law.[85] The MOU is now used for mutual law enforcement cooperation in cases involving non-public information.

The Law on International Mutual Legal Assistance in Criminal Matters (MAA) went into effect in Switzerland on January 1, 1983. Mutual assistance, in this context, means the service of court notices and subpoenas; the depositions of suspects, defendants, witnesses, and experts; the execution of house searches and seizures; and, the release and procurement of documents.[86] This act can be considered a historical watershed with respect to international mutual assistance, because once the specific requirements [87] of the law are met, foreign authorities of all countries have the right—as a matter of Swiss law, rather than international public law—to obtain extensive mutual assistance from Swiss authorities.

Under the 1977 U.S.-Swiss treaty, two criteria had to be met before the Swiss would justify the compulsory production of requested information: (1) dual criminality; and (2) either the alleged offense had to be included in the schedule attached to the treaty or the allegations in the request had to be of such importance as to justify compulsory measures. The MAA does not insist upon the fulfillment of these criteria to achieve disclosure. It does, however, prescribe certain mandatory requirements with respect to the form and content of a request for information. In addition, under Swiss constitutional law the MAA, which is a Federal law, does not preempt cantonal provisions., Mutual assistance proceedings must comport with the pertinent court procedures of the Swiss canton in which they take place. In two cantons in particular, persons subject to bank secrecy laws, such as bankers, may refuse to testify as witnesses or to hand over bank documents to the State authorities in civil as well as criminal matters.[88]

Bank documents frequently contain information that may lead to the identity of third persons who may be involved in an alleged criminal act. On this point, the MAA provides extensive protection of secrecy for persons who, by the terms of the request for mutual assistance, are not listed as a party to the criminal proceedings initiated abroad.[89]

The Swiss concept of mutual assistance is aimed at fiscal fraud,[90] and the MAA can not be used to disclose documents in tax reduction activities, provisions concerning currency, and trade or economic policy measures. Unfortunately, even when a request for disclosure is determined to have satisfied the basic requirements of the MAA, numerous means to contest disclosure remain available to the bank customer in question.

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[85] *The Economist* July 16, 1983, p. 70.

[86] Op. Cit. Note 79, Friedli, p. 7.

[87] The Swiss statute on judicial assistance, effective January 1, 1983, is one of the most complex. It consists of 112 Articles divided into six parts, although the 31 articles of Part 2 deal with extradition and the 24 articles of Parts 4 and 5 relate to matters other than evidence gathering. This leaves no less than 57 articles which apply to judicial assistance. In fairness, it must be said that the new Swiss statue is quite carefully conceived and many of its provisions are boldly innovative. In many respects, the Swiss in recent years have become the pioneers in international judicial assistance.

[88] Op. Cit., note 79, Friedli, p. 10.

[89] Ibid.

[90] Ibid., p. 11. Unfortunately, Swiss law does not have a general definition for fiscal cr tax fraud. One definition used is: tax fraud is tax evasion committed by means of falsified documents.

Currently, the Swiss government is considering a proposal to amend the SBA Article 47 which would further weaken bank privacy. If implemented, the proposal would result in two significant changes. First, a violation of banking secrecy through negligence would no longer be liable to automatic prosecution. Second, and more important, the Swiss banking commission would be granted the authority to allow a bank to disclose information otherwise protected.[91]

In the meantime, the Swiss Social Democrats proposed the "Initiative Against the Misuse of the Banking Secret and Banking Power" which was subjected to a general vote in 1984. This initiative was soundly defeated. If passed, it would have greatly expanded the possibility for disclosure of information now protected as secret under the existing law, as well as information which will be protected under the Swiss government's currently proposed amendments to SBA Article 47. According to the initiative, the banks would have had to provide tax authorities with detailed information about large groups of their customers. Both chambers of the Swiss Parliament voted against the initiative, and as noted, the electorate rejected it completely. Nevertheless, the very fact that such an initiative was proposed was seen by many as another indication that Swiss secrecy is steadily eroding.

CAYMAN ISLANDS

The Cayman Islands and the Bahamas are the two most significant common law jurisdictions in the Western Hemisphere having bank secrecy laws prohibiting the divulgence of customer information abroad.[92]

The Caymans introduced their first bank secrecy law in 1966. The law was modeled after the then extant Bahamian Banks and Trust Companies Regulation Act (1965), section 10.

In 1976, the Cayman legislature tightened their secrecy laws by passing the Confidential Relationships (Preservation) Act, thereby transforming the bank secrecy law into a sweeping business secrecy law. Strengthening of Cayman legislation was in direct response to the *U.S.* v. *Field* case. There, a grand jury subpoenaed a Cayman banker while he was in the U.S., and and held him in contempt when he claimed both the Fifth Amendment and Cayman Bank Secrecy law, and refused to testify.[93]

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[91] Ibid., p. 9.

[92] PSI Staff Study, p. 185.

[93] In *In re Grand Jury Proceedings. United States* v. *Field,* 523 F. 2d 404 (5th Cir.), cert denied, 429 U.S. 940 (1976) the Fifth Circuit affirmed contempt sanctions against a non-resident alien served with a subpoena while the United States who refused to testify before a grand jury investigating tax law violations, even though the very act of testifying may have subjected him to criminal prosecution in the Cayman Islands.

See also, In re Grand Jury, 81-2, 550 F. Supp. 24 (W.D. Mich 1982), where the district court said "recent case law from a wide variety of American courts reflects movement toward a general rule that a witness may not refuse to comply with a subpoena merely because compliance

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The Preservation Act was designed to clarify the Banking Act, and render the "misuse of confidential information . . . a criminal offense if committed in the islands and even if committed outside the islands in relation to Caymanian subject matter." [94] The Preservation Act defined "confidential information" as any "information concerning any property which the recipient thereof is not, otherwise than in the normal course of business, authorized by the principal to divulge." [95] In addition, the Preservation Act made the disclosure of such information a criminal act, punishable by a fine and imprisonment.

In 1979 the Preservation Act was amended in an effort to further clarify and strengthen the act by specifically prohibiting the disclosure of all confidential information with respect to business of a professional nature which arises in or is brought into the islands. The revision also sets out the procedures for a bank or a bank employee to follow when required to give evidence in a foreign proceeding, that is, notify the Attorney General of the Caymans and then "apply for directions" from the Grand Court of the islands.[96]

Section 3(b)(iii) of the Preservation Act provides for an informal method of obtaining disclosure when a Caymanian bank or company is willing to cooperate. However, the bank need not comply with the request, as the Department of Justice discovered during the *Interconex* case in 1981. There, Caymanian police went to the local branches of the Bank of Nova Scotia and Barclays Bank International seeking bank records but were refused based on leeway provided by local law which requires a "lawful order" from the Grand Caymanian Court if the banks demand it.[97]

Secrecy in the Cayman Islands is further discussed in the jurisdictional section below. A major recent development has been an agreement with the United States to facilitate disclosure of records in narcotics cases.

BAHAMAS

According to several knowledgeable bankers in the Bahamas, people investing their funds in offshore banking facilities have a very strong concern for secrecy and financial confidentiality—to the point of not wanting to change trust officer. During a recent series of PSI interviews, Bahamian bankers noted that it is very important to a trust company's customer that they be able to deal with the same trust officer over a period of years. It is for this reason that trust companies in the Bahamas cultivate a personal relationship with their clients whenever possible.

Prior to 1980, Bahamian Bank Secrecy Laws rested upon common law, violation of which could have led to civil suit. In addi-

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may subject him to sanctions in foreign countries." Id. at 28. Applying the Restatement (Second) balancing test the court concluded "United States interest in enforcing its criminal laws outweighs any countervailing interests or hardships asserted by the bank." Id. at 29.

[94] PSI Staff Study, p. 17.

[95] Ibid.

[96] PSI Staff Study, pp. 17-18.

[97] The *Interconex* case is considered a landmark case by the Justice Department. Through litigation to the Court of Appeals of the Cayman Islands, the United States established the judicial precedent in the Cayman Islands for the right to obtain the compelled testimony of bankers and the production of bank records through letters rogatory for use in American criminal trials, notwithstanding Caymanian secrecy statutes.

tion, the disclosure of confidential information was considered a crime under Section 10 of the Bahamian Bank and Trust Company Regulatory Act of 1965.

Up until 1975, Section 10 of the "Act" was thought to have provided for complete bank secrecy and confidentiality. But, in 1975 the Bahamian court decision of *Barclays Bank* v. *McKinney* held that Section 10 was applicable only to certain government officials, and not to banks or bank employees, with the exception of the Bank of Canada which at that time was the government's bank.[98] The direct result of this decision was that the common law provisions applied to government officials, bank officers and employees, while criminal law and penal sanctions applied only to government officials involved in their official duties.[99]

In 1980, Section 10 of the Banks and Trust Companies Regulation Act was amended to provide a blanket-type bank secrecy law which prohibits the disclosure of bank customer information without customer consent or judicial or executive approval. One of the drafters of the current law stated that the intent was to allow disclosure only after a court proceeding in the Bahamas. However, there are no tax treaties, mutual assistance treaties, other cooperation agreements with the U.S. and Bahamian courts may easily find no basis for ordering compliance.

From the standpoint of Bahamian secrecy proponents, the 1980 act presents a problem in that it appears to exempt from its ambit actions by a bank employee that are within the "performance of his duties". Thus, if a bank official were to comply with a foreign subpoena and release documents, or testify as to a customer's affairs, it might be said that he was merely fulfilling a normal function and, therefore, is not guilty of a criminal offense. At least until recently this point had not been judicially considered.[100]

Summary:

In summary, some level of banking of commercial secrecy is a characteristic common to both tax and non-tax havens. Thus, the real issue is not whether a jurisdiction has secrecy laws, but whether the jurisdiction has built into its laws an effective and efficient means of piercing that veil when there is reasonable suspicion that a crime has been committed.

Strict secrecy laws necessitate slow, time consuming and very expensive law enforcement techniques if they are to be pierced. Sophisticated criminals, by using one or more secrecy jurisdictions, rely on the delay secrecy laws engender frustrating law enforcement investigators beyond the statute of limitations period thereby escaping prosecution.[101]

As noted earlier, in an attempt to alleviate some of the enforcement official's frustrations and assist in the investigation and prosecution of criminals, Senator William Roth introduced the Acquisition of Foreign Evidence Improvement Act as an amendment to the Senate's Omnibus Crime Package (S. 1762). This legislation is designed to: (1) streamline the procedural steps for the admissibility of properly authenticated foreign business records; (2) permit the United States to attend foreign depositions in aid of gathering evidence; (3) require defendants who invoke blocking secrecy laws in foreign jurisdictions to file copies of their foreign pleadings with the U.S. courts; and, (4) when it can be shown that evidence located outside the United States is material to an investigation or trial, the statute of limitations and the Speedy Trial Act is extended a maximum of 3 years to facilitate the acquisition of that evidence.

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[98] PSF Staff Study, p. 20.

[99] PSI Interview with Bahamian banker.

[100] PSI Staff, Study, p. 184.

[101] John M. Fedders, "Preserving the Integrity of the Internationalized U.S. Capital Markets—Views on Methods by Which the U.S. Securities and Exchange Commission May See Production of Evidence", *Transnational Litigation: Practical Approaches to Conflicts and Accommodations*, Vol. 1 (American Bar Association National Institute 1984), p. 779.

The amendment was approved by the Senate in March 1984 as part of the Omnibus Crime bill and passed by the House almost without change as H.R. 5919. Ultimately, it was adopted as part of H.J. Res. 648, P.L. 98-473 (Oct. 12, 1984).

VII. PRINCIPAL HAVENS: CURRENT CONDITIONS

During 1981, 1982, and 1983 the subcommittee staff made visits to offshore financial centers and havens. Accompanying the staff on trips made in 1982 was Dr. Richard Blum of Stanford University, the subcommittee's consultant, who had previously visited some of these havens as part of his earlier research for the Department of Justice. Dr. Blum's report to the subcommittee was heavily utilized in the staff study on this subject published in 1982 and has been a valuable resource in the staff's continuing work.

In conjunction with these country sketches, interviews were held with banking, business, and legal professionals, with members of government banking and finance regulatory bodies, law enforcement people, participating users of offshore havens, and with U.S. State Department personnel.

Given that there are dozens of recognized tax havens in the world, almost all of which offer some form of secrecy protection, it was necessary to narrow this review to certain jurisdictions which are representative by virtue of their laws and policy. The following country descriptions summarize the subcommittee's investigation and synthesize a great deal of independent research conducted by the staff during the course of the subcommittee's lengthy investigation.

ANGUILLA

In many ways Anguilla typifies the "emerging" tax haven jurisdiction. Offshore expert Walter Diamond writes that it "hopes to make a major impact upon the tax haven world." To illustrate his point, Diamond notes that Anguilla avoids all types of taxation, including an income tax which has not been collected from islanders in many years.[102] On the other hand, during PSI's hearings, Jerome Schneider, President of the WFI Corporation, stated his view that Anguilla is a "time bomb waiting to blow up." [103]

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[102] Walter H. Diamond, "Tax Havens of the World: Anguilla," Volume 1, Matthew Bender, 1974-1983, New York, p. 2. (Hereafter cited as Diamond, "Tax Havens").

[103] Hearings, p. 183.

In December 1980, Anguilla legally separated from the Associated States of St. Kitts-Nevis-Anguilla to become a British colony. Revenues are raised from customs duties and stamps, construction, tourism, and offshore business.[104] In 1979, a committee established to study tax haven incentive legislation concluded that the growth of marine registration, banking (including offshore banking), and captive insurance companies should be encouraged.[105] Anguilla faces competition from the more established Caribbean tax havens such as the Bahamas, British Virgin Islands, Panama and the Cayman Islands. However, Anguilla's stature as a tax haven is enhanced by several factors: There are no exchange controls, money moves freely into and out of the island without question, and until recently, Anguilla had a double taxation treaty with the United States as well as other nations. Since the United States has canceled this treaty with British colonies as of January 1, 1984, it remains to be seen how Anguilla's status as a tax haven will be affected.

According to information received from the Department of State in 1983, there were three Class A banks in Anguilla doing business domestically as well as offshore, and 72 Class B banks which are allowed to do business only offshore. The capital requirements for Class A or B banks is the equivalent of U.S. $186,000 if the main office is in Anguilla; U.S. $744,000 if the headquarters is outside Anguilla. The annual licensing fee for Class A banks is only U.S. $4,650. Class B banks cost only U.S. $3,720 to license if they are physically present on the island. Bank license fees were expected to yield only U.S. $280,000 in 1983. As of 1983, offshore expert Diamond claims that more than 120 banks have been banished for failure to comply with the licensing requirements but it is not clear over what period of time.[106]

Anguilla, as a British colony, is subject to British common law which is supplemented with local statutes. There is a Confidential Relationship Ordinance which prohibits the divulging of information obtained under business or professional confidence.

Jerome Schneider who charters and sells private banks told PSI that Anguilla's bank licensing requirements are lax:

> Anguilla is probably the best example in the world of a country which in my opinion, does not vet license applications. . . . The Government of Anguilla does not scrutinize or approve the subsequent transfer of ownership of such banks once they are licensed. This affords the criminal the opportunity to acquire a bank charter without any background checks. . . . In many cases, one can simply fly down to Anguilla to acquire a bank charter simply by providing two bank references, which I understand are not even checked.[107]

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[104] Diamond, "Tax Havens", p. 4.

[105] Ibid, p. 2.

[106] Diamond, "Tax Havens", p. 2.

[107] Hearings, pages 183–184.

During the subcommittee's hearings Glen Archer, Assistant Attorney General (Tax), elaborated on the growth of banks in the Caribbean:

> In the small island of Anguilla, there were only 3 banks 3 years ago, but today there are reportedly 96 banks. Of those 96 banks, only one apparently has a vault. There are paper banks being marketed in many tax haven countries. They are being marketed to people in the United States. Brokers of these banks often intimate although they usually don't state directly, that the offshore paper banks can be used for illegal purposes or concealment.[108]

Indeed, in the past, some Anguillan offshore banks have been associated with fraud schemes in the U.S. One recent case illustrates how Anguillan facilities are allegedly used. In *United States* v. *McDevitt,* Crim. No. 4-82-70 (N.D. Tex 1982), Donald T. McDevitt, Esq., Michael A. Carr, and Keith D. Kantor, licensed insurance salesmen, were indicted for defrauding insurance companies and tax fraud. The defendants incorporated companies to write "keyman" insurance policies and, through Union Commerce Bank and Trust, Anguilla, West Indies, which they owned, they purportedly falsified loan letters, financial statements, employment references and overstated assets and annual incomes. They were also charged with tax fraud in a scheme which involved the solicitation of clients for "business consultations" with McDevitt's Bahamian based company, Interamerican Indemnity, Ltd.—consultations which in fact never occurred. Ten percent of the fee allegedly would be split between the client and the defendant and 90% returned in loan form thus avoiding tax on the entire amount, as business deduction and nontaxable loan respectively.

In the recent past, Anguilla has cooperated with U.S. law enforcement and State Department personnel while, at the same time, giving every indication that it plans to aggressively pursue offshore business.

ANTIGUA

The 18 square mile island of Antigua is located in the Eastern Caribbean 250 miles southeast of Puerto Rico. In the past, sugar plantations have accounted for much employment and significant exports. But large scale operations at the sugar plantations were terminated during the 1970's due to soil depletion, unfavorable market conditions and inconsistent patterns of rainfall. Sea island cotton is now a large enough source of income to be exported. Tourism has grown enormously and makes up two-fifths (40%) of the gross national product (GNP for 1981—U.S. $79.1 million) and provides three-fifths (60%) of the country's jobs (population 1982—77,226), although income from tourism declined slightly during 1980-1981 due to the economic recession in the major industrial nations. A $130 million budget deficit for 1982-1983 has been a major problem for the Antiguan economy. Antigua became an independent country within the British Commonwealth in November 1981 and has enjoyed political stability since that time, although sources told staff investigators that there is much political opposition to the current rulers and there have been accusations of corruption.

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[108] Ibid., at p. 8.

On December 31, 1982, Antigua enacted the International Business Corporations Act (Law No. 28 of 1982) which grants income tax exemption to international business corporations and provides for the establishment of international banks and captive insurance companies. No income tax is imposed upon the exempt income of an international business corporation (IBC), an international bank, an international insurance company or a qualified trust company for at least 20 years after incorporation. The island does not levy any capital gains or estate tax, there are no reserve requirements for an IBC bank, and its exchange controls are generally slack and ineffective.

An international trade or business under the act includes: International banking, international trust business, international insurance corporations as well as other international trading or commercial activities.[109] An international business corporation, to maintain its exempt status, must carry on no business in Antigua and Barbuda except in support of its offshore activities. Licenses are required for international banks, trusts and insurance businesses.[110] The license is granted only upon the discretion of the Supervisor of International Banks and Trust Corporations and it may be revoked at any time the company violates the conditions of its exempt status, or the supervisor determines the bank is not operating in the public interest. Capital registration fees for a bank amount to $655. Together with a license, an initial fee of U.S. $5,000 for an international banking business and U.S. $2,500 for international trusts and insurance business are required before the corporations can carry on a trade or business. The amount of the initial fee is also required to be paid as an annual fee.[111]

Minimum stated capital requirements are made in the case of all international business corporations. A banking corporation is required to maintain a stated capital account of U.S. $10,000,000 or, if owned by one or more foreign concerns with reserves in excess of $10,000,000, it is required to maintain a U.S. $1,000,000, capital account. Trust corporations and insurance corporations are required to maintain a stated capital account in an amount at least equal to U.S. $500,000.[112] Just what this means in terms of "cash on hand", however, is unclear.

IBC banks must file audited quarterly returns with the Supervisor of Banks and Trusts Corporations.[113] An international bank is not subject to the restrictions of the Exchange Control Act of 1958 or the 1% levy on foreign currency transactions imposed by the Foreign Currency Act of 1976.

Secrecy provisions of the act are very stringent and similar to those of the Caymans and Bahamas. There are criminal penalties of up to U.S. $18,850 and a prison term not exceeding 1 year for inquiries or disclosures concerning the business affairs of a bank or a transaction with a bank. Section 244 of the act provides:

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[109] International Business Corporations Act, (Law No. 28 of 1982).

[110] Ibid., § 282–283.

[111] Ibid., § 238(1), § 246, and § 26.

[112] Ibid., § 227.

[113] Ibid., § 241, § 242.

> (1) . . . no person shall disclose any information relating to the business affairs of (a) customer that he has acquired as an officer, employee, agent, auditor, solicitor of the banking corporation, or otherwise in the performance of his duties . . . except in the performance of his duties . . . pursuant to an order of a court . . . in Antigua and Barbuda.
>
> (2) No person shall inquire as to any matters covered under subsection (l) except in performance of his duties under this act.
>
> (3) No statement, return or information submitted under 242 or 243 may be required with respect to the affairs of any customer of a banking corporation; and the supervisor must note (this information) as confidential.
>
> (4) Nothing in this act impairs the (banks duty) to protect the confidentiality of the business affairs of its customers.
>
> (5) No court shall (issue) under subsection (l) except in connection with an investigation authorized under this act or in connection with the giving of evidence in for the purpose of or in the course of the trial of any person in respect of an alleged criminal offense reside within Antigua and Barbuda or which would have been so triable if it had been committed within Antigua and Barbuda.[114]

Section 244 is made expressly applicable to activities of an international trust corporation. Also, financial statements submitted pursuant to the reporting requirements of an international insurance business are deemed confidential under the act.

Antigua is one of the countries included in the January 1, 1984, cancellation of the United States-United Kingdom Income Tax Treaty, but it had notified the U.S. Government on November 5, 1982, of its wish to terminate the existing treaty. Renegotiation of a treaty arrangement is not a high priority in either the United States or Antigua.

Even before the 1982 business corporations legislation was passed, Antigua had been involved in a publicized offshore bank swindling scandal. Costa Rican banker-businessman Arnoldo Luis Rodriguez, alias Jimmy Chinchilla and Arnoldo Luis Rodriguez Breche, was found guilty of defrauding John M. Felt, a Salt Lake City businessman of $120,000. The sum represented prepaid interest for a loan Rodriguez purported to make to Felt for $1 million from the Agrindustrial Bank of Commerce, Antigua, of which Rodriguez claimed to be president. In reality, the bank was not licensed to do business and maintained no facilities nor deposits in Antigua and the $1 million cashier's check turned out to be worthless. Rodriquez has been described by the Justice Department as "the economic crime equivalent of an international terrorist". French officials claim he heads "an international fraud organization with other connections in the United States, Belgium, Canada, Denmark and England." [115]

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[114] Ibid.

Antigua does not have a central bank or a bank which issues currency but it has been a member of the East Caribbean Currency Authority which was renamed the Eastern Caribbean Central Bank on October 1, 1983. The Preamble of the Agreement of ECCB states:

> An agreement made on the 5th day of July, 1983, between the Governments of Antigua and Barbuda, The Commonwealth of Dominica, Grenada, Montserrat, Saint Christopher and Nevis, Saint Lucia and Saint Vincent and the Grenadines (hereinafter referred to as "the participating governments")
>
> Whereas it is desired to maintain a common currency and to establish a Common Central Bank with powers to issue and manage that currency, to safeguard its international value, to promote monetary stability and a sound financial structure and to further the economic development of the territories of the participating governments.

The agreement further states that the purposes of the bank are to: (1) regulate the availability of money and credit (2) promote and maintain monetary stability (3) promote credit and exchange conditions and a sound financial structure conducive to the balanced growth and development of the economies of the territories of the participating governments and (4) actively promote through means consistent with its other objectives and economic development of the territories of the participating governments. Insofar as the Bank's authority and jurisdiction extends to offshore banks, the agreement states in Part IX-41:

> (1) The Bank shall act as agent for the participating governments in the administration of any law or regulation relating to exchange control; and in accordance with such instructions as the Council may, from time to time, issue in the licensing of any offshore banking or offshore trust operation.
>
> (2) The Bank shall monitor the operations of offshore financial institutions in accordance with the laws or regulations under which such financial institutions have been licensed to operate and shall take account of such guidelines as the Council may, from time to time, issue for this purpose.[116]

Thus far, ECCB "monitoring" of the offshore banks of member States has yet to be seen.

THE BAHAMAS

The Bahamas is recognized worldwide as a major offshore financial center. Its rise to this position has been assisted by its political stability,[117] its proximity to the United States, its freedom from tax, a developing set of banking and corporate laws, and other factors which have spurred growth of offshore financial centers. The Bahamas entered the burgeoning field of offshore banking early and aggressively, and probably still ranks as the leading Caribbean offshore center with the Cayman Islands and Panama trailing.

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[115] United Press International Wire—September 12, June 9, 1982; see also, *United States* v. *Rodriquez* (Cr. No. CR-A2-0067 (D.C. Utah) August 16, 1982).

[116] Eastern Caribbean Central Bank—Agreement 1983—pp. 1, 2, 19.

Financial Sector Importance to Bahamian Economy

Throughout several meetings in Washington, D.C. and Nassau, the Bahamian Government has made it clear to PSI that its financial sector is crucial to the country's economy. In 1979, (the last year for which figures are available) the Bahamian GNP was $1.083 billion with an annual growth rate of 3 to 4 percent.[118] Though it is impossible to determine what percentage of the GNP is directly attributable to the financial sector, other available statistics give a clear indication of the sector's importance. The average salary for bank and trust company employees was $13,296 in 1979 whereas per capita income in other sectors was $4,650.[119] In a country where unemployment probably ranges from 20 to 22 percent the financial sector employs 10 percent (2,818 employees in 1981) of the population, ranking third behind the government (30%) and the tourist industry (25%).[120] In addition, the sector supports over 200 attorneys and 120 chartered accountants. Eight of the nine largest international public accounting firms are represented in the Bahamas.[121] Both the tourist and financial sectors continue to grow at a rapid rate, though the former has been adversely affected by the recent worldwide recession and the strength of the U.S. dollar (with which the Bahamian dollar is at par) against the European currencies.

Employment in the financial sector has increased 25% from 1973 to 1981, and average salaries have increased 43 percent.[122] The number of bank and trust licenses in force increased from 191 in 1973 to 237 in 1981, and 349 in 1983.[123] Thus, the general growth of the financial sector has made a significant contribution to the growth in the GNP.

Several additional factors add to the importance of the financial sector to the Bahamian economy. The unemployment rate tends to create social pressures due to the high education level of a significant number of the unemployed, and an expanding birth rate. The proximity of the Bahamas to the U.S. with its heavy exposure to Miami television, radio and newspapers has raised the economic expectations of the Bahamians. In addition, inflation has sharply increased from approximately 3% in 1978 to 7% in 1979 and to an estimated 13% in 1981. Growth of the financial sector would offer well paying, white-collar jobs with excellent opportunities for advancement to many of the otherwise unemployed.[124]

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[117] The Bahamas has had its own elected parliament since 1729 and became independent from Great Britain in 1973.

[118] Foreign Economic Trends and Their Implication for the United States, January 1983, p. 4, U.S. Department of Commerce.

[119] Ibid.

[120] Ibid.

[121] International Banking and Trust Activities in the Bahamas—January 1983, published by the Central Bank of the Bahamas and Association of International Banks and Trust Companies in the Bahamas, p. 19.

[122] The Economic Contributions of the Banking and Financial Sector in the Bahamas. Excerpts provided by the Central Bank of the Bahamas in 1983 can be found in the Subcommittee's files.

[123] See note 121, supra, at p. 6.

Conversely, increased consumer expectations, growing inflation, high unemployment and the fact that the Bahamas is in the middle of the South American-U.S. drug trafficking freeway have combined to increase the Bahamian crime rate. Continued growth in the crime rate could have a significantly adverse impact on the tourist trade and thus damage the economy.

The Bahamian government sees the expanding financial sector as a strong countervailing force to these economic problems. It is fully committed to its continued expansion.

Banking and Trust Company Operations

Bank, trust and company operations are primarily regulated by the Banks and Trust Companies Regulations Act of 1965, as amended in 1980, and the Companies Act of 1866, as amended. Under these laws, the main types of financial activity in The Bahamas consists of domestic commercial banking, international commercial banking, and international trust banking.

The 349 banking and trust licenses in force as of June 1983 can be divided into six categories. Ten licenses are in force allowing Authorized Dealer status. Authorized Dealers include seven clearing banks (four Canadian, two American and one British) and three of their trust company operations. Authorized Dealers provide the bulk of the local currency banking needs.

There are eight Authorized Agent licenses which allow trust operations and provide the majority of the country's international fiduciary, corporate agency, and portfolio management services. One hundred and thirty-three foreign bank branches are licensed in The Bahamas and act as offshore booking centers for Eurocurrency loans and deposits. Most of these banks do not require their own staff or premises. Ninety-one of them are U.S. banks.

Of the licenses in force, 104 are Bahamian incorporated institutions. Seventy-four of these are subsidiaries of banks based outside the Bahamas and 30 are Bahamian based.

Eighty-six of the 349 licenses held were for restricted operations. These restricted licenses allow operations only within a closely defined boundary. The balance of the licenses (8) are nonactive. It is important to note that nonactive status does not indicate that these are "shelf" banks, formed and held for later sale to the highest bidder. The Bahamas does not permit the formation, licensing and holding of shelf banks.[125]

The following graph prepared by the Central Bank of the Bahamas illustrates bank and trust operations in the Bahamas.

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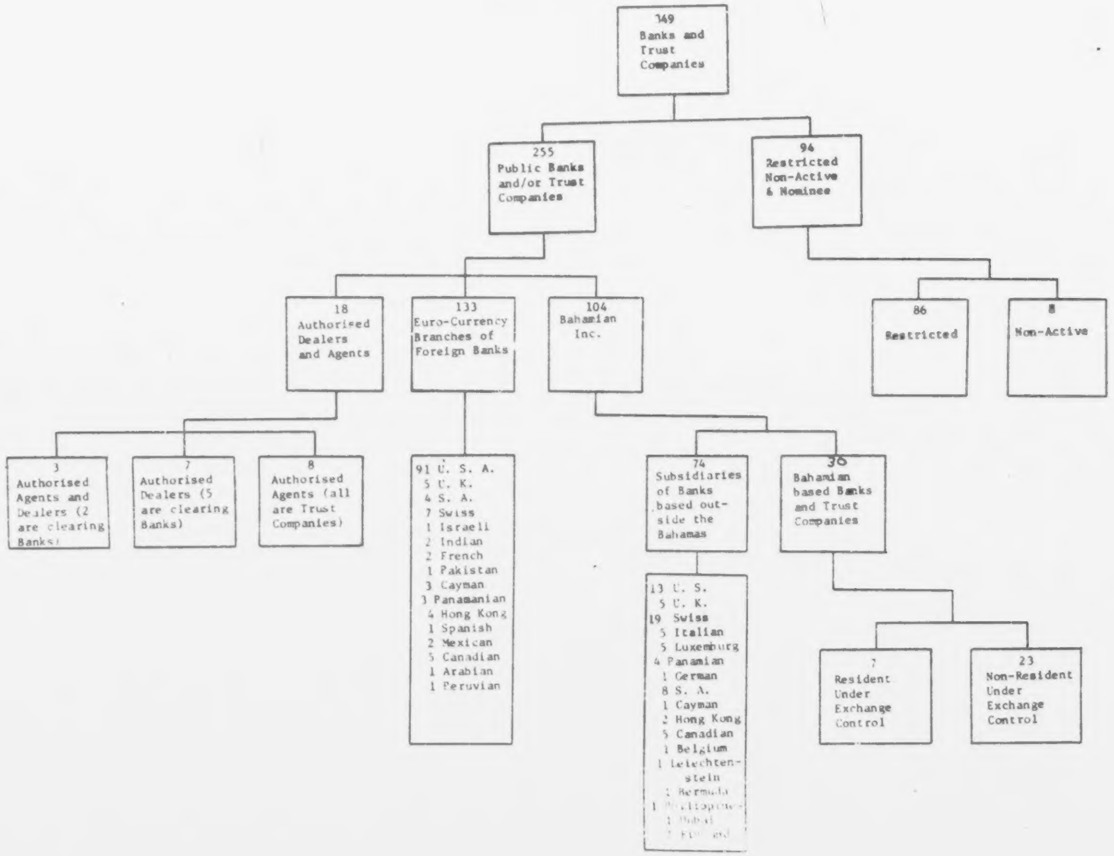
[124] Ibid.

[125] Ibid.

(CHART)

BANK AND TRUST COMPANIES IN THE BAHAMAS

AS AT JUNE 30TH, 1983


349
Banks and Trust Companies
255
Public Banks and/or Trust Companies
94
Restricted Non-Active & Nominee
18
Authorised Dealers and Agents
133
Euro-Currency Branches of Foreign Banks
104
Bahamian Inc.
86
Restricted
8
Non-Active
3
Authorised Agents and Dealers (2 are clearing Banks)
7
Authorised Dealers (5 are clearing Banks)
8
Authorised Agents (all are Trust Companies)
91 U. S. A.
5 U. K.
4 S. A.
7 Swiss
1 Israeli
2 Indian
2 French
1 Pakistan
3 Cayman
3 Panamanian
4 Hong Kong
1 Spanish
2 Mexican
5 Canadian
1 Arabian
1 Peruvian
74
Subsidiaries of Banks based outside the Bahamas
30
Bahamian based Banks and Trust Companies
13 U. S.
5 U. K.
19 Swiss
5 Italian
5 Luxemburg
4 Panamian
1 German
8 S. A.
1 Cayman
2 Hong Kong
5 Canadian
1 Belgium
1 Leiechtenstein
1 Bermuda
1 Phillippines
1 Dubai
1 Finland
7
Resident Under Exchange Control
23
Non-Resident Under Exchange Control

It is impossible to obtain a firm grasp of the size of the Bahamian banking and trust system. The Central Bank has not required reporting of the purely offshore operations of banks and trusts. Such reports have been voluntary, and those that are filed generally show a consolidated picture of the parents' international operations.[126] In addition, because of the highly sensitive and confidential nature of Bahamian trust operations, the Central Bank does not require trust companies to report any figures relating to assets managed.

According to the Central Bank, a large Nassau trust company recently reported "off-balance sheet" figures of assets under management of between $2 to $3 billion, which require a staff of 220 persons to administer. Another trust acknowledged assets under management of over $1 billion and several others are reportedly in the several hundred million to over $1 billion range. The Central Bank has made a rough approximation that the total assets under trust management might be in the neighborhood of $10 billion, virtually all of which are external and held on behalf of foreign clients.

The true size of bank holdings in the Bahamas is elusive. The International Monetary Fund reported the external liabilities of U.S. banks in the Bahamas to be $97 billion in mid-1982. Authorized Dealers reported their mid-1982 external liabilities to be $42 billion. Using these figures and other data, the Central Bank estimates the external liabilities of banks in the Bahamas to be around $141 billion.[127]

Operations of Companies (Other Than Banks or Trusts)

The procedures for establishing a company in the Bahamas are quite simple. A Memorandum of Association is required to be filed with the Registrar General along with the appropriate signatures and the payment of fees. The Memorandum must be signed by at least five shareholders and a witness. Filing fees are $275. The stamp duty for companies owned 60% or more by Bahamians are $60 for capitalization of $5,000 or less and an additional $3 per $1,000 above $50,000. Annual license fees are $240 for Bahamian owned companies and $1,000 for those whose ownership is less than 50% Bahamian.

Foreign companies willing to operate in the Bahamas must register with the Registrar General, disclosing the names of company officers, directors, and managers and other nominal information concerning shares issued, outstanding, etc. Foreign companies are subject to a $600 duty and a $1,000 annual fee.

Certain exchange control requirements are imposed on foreign companies but these rarely pose difficulties.

There are virtually no other controls over companies in the Bahamas, other than those laws which apply to the citizenry at large. Noteworthy is that bearer shares are not allowed. There is no procedure for withdrawing a license of a company, but companies that fail to pay their annual fees or file their annual returns are eventually placed on a liquidation list.[128]

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[126] See note, 122, supra.

[127] See note 121, supra, at p. 12. The difficulties in ascertaining the relative sizes of various banking centers are outlined elsewhere in this report.

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[128] The basic requirements for forming a company in the Bahamas are set forth in the following memorandum from the Registrar General's Department of the Bahamas.

REGISTRAR GENERAL'S DEPARTMENT

Post Office Building

East Hill Street

Nassau, Bahamas

The requirements which have to be met in the incorporation of companies in the Bahamas are laid down in the following statutes and statutory Instruments:

(a) The Companies Act (Chapter 184);
(b) The Companies (Amendment) Act 1965 (No. 53/65):
(c) The Companies (Amendment) Act 1967 (No. 18/67);
(d) The Companies (Amendment) Act 1969 (No. 19/69);
(e) The Companies (Amendment) Act 1975 (No. 35/75);
(f) The Companies (Variation of The Schedule Regulations 1971 (No. 73/71));
(g) The Foreign Companies Act (Chapter 186);
(h) The Banks Act (Chapter 96) relating to companies which intend to carry on business as banks;
(i) The Banks (Amendment) Act 1965 (No. 65/65);
(j) The Banks and Trust Companies Regulation Act 1965 (No. 64/65);
(k) The Banks and Trust Companies Regulation (Amendment) Act 1968 (No. 34/68) and
(l) The Banks and Trust Companies Regulation (Amendment) Act 1969 (No. 20/69).

In order to incorporate a company in The Bahamas, a copy of the Memorandum of Association has to be filed with the Registrar General. The Memorandum should be signed by a minimum of five subscribers, who must subscribe for at least one share each, and witnessed by a sixth person who will be required to sign and swear to an affidavit stating that the Memorandum was signed in his presence by the five subscribers concerned. A subscriber who is a non-resident of The Bahamas or the scheduled territories (Commonwealth Countries, except Canada), or who is a nominee of such person, must obtain permission of The Controller of Exchange, such permission is usually not difficult to obtain. A filing fee of $275.00 is payable in respect of every Memorandum of Association. The Memorandum of Association gives the name of the company, which must contain "Limited" as the last word except where permission has been granted by His Excellency, the Governor-General of The Bahamas, the company's objects and its authorised capital. It must also state the part of the Commonwealth in which the registered office is proposed to be situated.

It is optional to file Articles of Association along with the Memorandum of the company at the time of incorporation. The Articles should also be signed by the five or more subscribers and duly witnessed by a sixth person. A filing fee of $15.00 is payable in respect of the Articles of Association.

Before incorporating a company it is necessary that the proposed name be approved by the Registrar General as meeting the requirements laid down in the Companies Act and The Business Names (Use of Royal Titles) Act. A person may therefore apply in the prescribed form to the Registrar General for the reservation of the name of the intended company and after securing the approval of the name may proceed to file the necessary document of incorporation.

Stamp duty is also payable on the authorized capital based on the following schedule as contained in the Stamp Duty. Any further increases in the authorised capital after the company has been incorporated also attract further stamp duty:

Every Memorandum of Association of a company where the capital is $5,000 or under, $60.00 is payable.

Every additional $1,000 or fraction thereof, $3.00 is payable.

If the authorised capital of the company is increased after incorporation these additional fees are payable on filing the resolution:

Every resolution increasing the capital of a company incorporated within The Bahamas, for every $1,000 or fraction thereof of the increase, $3.00 is payable.

An annual license fee of $250.00 is payable in respect of registered companies in which not less than 60 per centum of its shares are beneficially owned by Bahamians. A registered company in which less than 60 per centum of its shares are beneficially owned by persons who are Bahamians must pay an annual fee of $1,000. This fee is payable on the 1st day of January in each year but a period of grace not exceeding thirty days may be allowed by the Registrar General; provided that no such fee is payable in respect of a company which was registered on or after the 1st day of July in the preceding year.

Non-Profit companies, i.e., companies granted a license by the Governor General under the provisions of section 59 of The Companies Act, are exempted from the payment of the annual fee. These companies are, however, required to pay the usual filing fee, but the stamp duty payable is reduced to $5.00 on each company.

Continued

According to the U.S. Embassy in Nassau, the actual number of companies in the Bahamas is unknown. However, the Bahamian registrar's office puts the approximate number of companies, as of December 1983 at 30,000, of which 2,000 have been placed on the liquidation list.

Government Oversight of Banks, Trusts, and Companies

In June 1974, one year after the Bahamas became an independent country, the Bahamian Monetary Authority (formed in 1968) was succeeded by the Central Bank of the Bahamas. During this period the Bahamian authorities significantly increased their regulation of banking and trust operations: Eighteen bank licenses were revoked in 1973, 20 were revoked in 1974 and 15 were revoked in 1975.[129]

The Central Bank participates actively in the deliberations of bank supervisory authorities organized under the auspices of the Bank for International settlements (BIS) in Basel, Switzerland. The Central Bank also participates in the World Bank, the Caribbean Development Bank and the Interamerican Development Bank.[130]

Licenses for banks and trust companies in the Bahamas are granted through the Ministry of Finance after application is made

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Foreign or Overseas Companies: In order to be registered under the provisions of The Foreign Companies Act, a company must have been incorporated outside of the Bahamas, and must deposit with the Registrar General a copy of the Act, Charter or other document of incorporation of such company duly authenticated under public seal of the country in which it has been incorporated. The company must also cause a public notice to be inserted in the Gazette to the effect that such certified copy has been deposited, and the notice should set forth the island or part of the Commonwealth in which the company has established its registered office. The duty imposed on a foreign company is $600.00 and the registration fee of $14.29. All companies registered under the Foreign Companies Act must pay an annual fee of $1,000.00.

All Foreign companies must file with the Registrar General copies of any special resolutions, names of all company officers, directors, managers and are required by law to have a registered office address which must be brought to the notice of the Registrar General. In the case of banks, proper records have to be kept and annual statements showing the bank's true financial position must be published in the Gazette. Every* company which has its capital divided into shares is required to file at the Registry an annual return containing the following information:

(a) A list of company members stating the names, addresses and occupations of all members mentioned and the number of shares held by each;
(b) Amount of the company's capital and number of shares into which it is divided;
(c) Number of shares taken from the formation of the company up to the date of the summary;
(d) Amount of calls made on each share;
(e) Total amount of calls received;
(f) Total amount of calls unpaid;
(g) Total amount of shares forfeited;
(h) Names, addresses and occupations of persons who have ceased to be members since the last list was compiled and number of shares held by each of them.

*All companies, except those registered under Section 59 of The Companies Act must send to the Registrar General a copy of the register containing the names, addresses and occupations of its directors or managers and must notify the Registrar General of any subsequent change which takes place in such officers and directors.

Subject to the permission of the Controller, a company may be incorporated with its capital expressed in a foreign currency. Such permission is also not difficult to obtain from the Controller, Exchange Control, c/o Ministry of Finance, Post Office Box N 3017, Nassau, Bahamas. Copies of the legislations referred to in this information leaflet may be obtained from the Cabinet Office, Post Office Box N 7147, Nassau, Bahamas.

Declarations of Beneficial ownership of company stating whether or not a company is Sixty percent owned by Bahamians or non-Bahamians must be filed, along with the Annual payment of the Company fees.

A letter regarding the situation of office of the company must also be filed.

Please note that these Declarations must be signed by a Director and a Secretary, or two Directors.

[129] International Banking and Trust Activities in the Bahamas, Op. Cit., note 5, p. 6.

[130] Ibid, at p. 21.

to the Central Bank. These licenses fall into the categories noted in the previous section of this report and the 1983 fees were as follows: [131]

Banking category:	*Annual fee*
Authorized dealer	$50,000
Authorized agent	30,000
Ordinary license to carry on a general banking and/or trust business	10,000
Restricted banking and trust business	3,000
Restricted trust business only	1,500

New banks must have a paid up capital of $1 million. The paid up capital of a parent corporation will suffice for branches established in the Bahamas.[132]

According to Central Bank Authorities, bank applicants are carefully screened prior to licensing. To obtain a license, a bank must have five unrelated and independent shareholders. Subsequent sales of shares after licensing are likewise reviewed to ensure continued independence of at least five shareholders.

Every licensed bank and trust company incorporated in the Bahamas must submit an annual, locally certified financial statement to the Central Bank. In addition, every bank licensee must publish its balance sheet in the Official Gazette within 4 months of the end of its fiscal year. Financial statements of parent banks are sufficient for their Bahamian branch operations. As previously noted, the financial statements of offshore trusts do not need to reflect assets under management by the trust.

While the Central Bank to some extent supervises local banks licensed in the Bahamas, it definitely looks to the home jurisdiction of parent banks to supervise their offshore branches located in the Bahamas. The Bahamas has a very active Association of International Banks and Trusts (AIBT) which works closely with the Central Banks.[133] In early 1984, the Central Bank began requiring attorneys and accountants who managed nominee accounts to get advanced permission from the Central Bank to do so. The Central Bank also began requiring monthly reports of foreign currency moving in and out of nominee accounts.

The Central Bank endorses the recently revised concordat issued by the Bank For International Settlements in 1983. Richard Dale, writing in the September 1983 issue of *The Banker,* notes that the aftereffects of the collapse of Banco Ambrosiano were "one factor prompting a reappraisal of the original concordat." The Bahamas was particularly sensitive to the Ambrosiano collapse as Ambrosiano had a large operation in the Bahamas with 56 employees and a newly completed but never occupied large, modern office building. The Bahamian operation of Ambrosiano was put into receivership and was approximately $350 million in debt. The recordkeeping of the Bahamian branch of Ambrosiano was such that it may be impossible to sort out what really transpired in the Ambrosiano/Bahamian operations. The revised concordat is designed to promote the type of supervision necessary to forestall such a collapse in the future.

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[131] Ibid.
[132] Ibid., at p. 17.
[133] See discussion of Bahamian banking diligence, supra, Part V.

Bahamian Secrecy Laws

The Bahamian secrecy laws are legislated in Section 10 of the Bank and Trust Companies Regulation Act of 1965, as amended in 1980.[134] The Bahamian secrecy law is sweeping and carries severe penalties. Like so many similar provisions of foreign law, the Bahamian version can be pierced but the procedures are not clear. Much is left to the imagination of the party seeking disclosure. It is clear from the act that a Bahamian court can order disclosure via an application pursuant to letters rogatory. But this requires resort to the letters rogatory process and the evidence act applicable thereto. The (evidence) proceedings in the Foreign Jurisdictions Act, 1976, which most former or current English Colonies would likely follow, allows for the production of evidence in criminal matters only after "institution" of the proceedings, and in civil matters, only when the proceedings to which the evidence related to have been "contemplated."

Hence, indictment disclosure of records in the Bahamas appears to be unlikely. Recent letters rogatory successes by the Department of Justice have involved post-indictment situations. There is no case precedent established in this area and Bahamian government officials and attorneys seem unsure of how far their courts will go.

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[134] Bahamian secrecy law is included in the Banks and Trust Companies Regulation Act of 1965 (as amended, 1980):

BAHAMIAN ACT No. 3 OF 1980

An Act to amend the Banks and Trust Companies Regulation Act, 1965

(Assented to: 24th March, 1980)

(Commencement: 24th March, 1980)

Enacted by the Parliament of The Bahamas.

1. This Act may be cited as the Banks and Trust Companies Regulations (Amendment) Act, 1980.

2. Section 10 of the Banks and Trust Companies Regulation Act, 1965 is repealed and the following section substituted—

10. (1) No person who has acquired information in his capacity as—

(a) director, officer, employee or agent of any licensee or former licensee;

(b) counsel and attorney, consultant or auditor of the Central Bank of The Bahamas, established under section 3 of the Central Bank of The Bahamas Act, 1974, or as an employee or agent of such counsel and attorney, consultant or auditor;

(c) counsel and attorney, consultant, auditor, accountant, receiver or liquidator of any licensee or former licensee or as an employee or agent of such counsel and attorney, consultant, auditor, accountant, receiver or liquidator;

(d) auditor of any customer of any licensee or former licensee or as an employee or agent of such auditor;

(e) the Inspector under the provisions of this Act, shall, without the express or implied consent of the customer concerned, disclose to any person any such information relating to the identity, assets, liabilities, transactions, accounts of a customer or a licensee or relating to any application by any person under the provisions of this Act, as the case may be, except—

(i) for the purpose of the performance of his duties or the exercise of his functions under this Act, if any; or

(ii) for the purpose of the performance of his duties within the scope of his employment; or

(iii) when a licensee is lawfully required to make disclosure by any court of competent jurisdiction within The Bahamas, or under the provisions of any law of The Bahamas.

(2) Nothing contained in this section shall—

(a) prejudice or derogate from the rights and duties subsisting at common law between a licensee and its customer; or

(b) prevent a licensee from providing upon a legitimate business request in the normal course of business a general credit rating with respect to a customer.

(3) Every person who contravenes the provisions of subsection (1) of this section shall be guilty of an offense against this Act and shall be liable on summary conviction to a fine not exceeding fifteen thousand dollars or to a term of imprisonment not exceeding two years or to both such fine and imprisonment.

Recent experience does indicate that a post-indictment application pleading the usefulness of bank or company records in prosecuting the crime would be favorably received by the Bahamian court, so long as the crime charged is an offense under its law. Since there are no taxes in the Bahamas, the prosecutor or defense counsel contesting a Title 26 prosecution is out of luck. If the underlying case happens to involve fraud or narcotics, disclosure is more likely.

Preservation of secrecy is widely held by the government, attorneys, and bankers to be absolutely critical to the continued success and growth of the Bahamas as a major international financial center. There is little doubt that secrecy laws will be maintained and even strengthened as deemed necessary by aggressive prosecutorial efforts for disclosure, such as the litigation between the U.S. and the Bank of Nova Scotia. The Bahamas shares the conviction held by Panama and the Caymans that, without secrecy, the financial sector will collapse. This is not to say that secrecy is completely impenetrable. A customer, who generally has control of the secret, may waive a secrecy law as it applies to specific transactions or accounts. In fact, the Central Bank informed PSI that several banks require such a waiver from U.S. customers prior to opening an account in the Bahamas. This, when coupled with the reporting to the Central Bank of large transactions, is seen in the Bahamas as a significant step in stemming the flow of illegal gains through the banking system.

From the U.S. law enforcement prospective, however, it is difficult to judge the effects of these initiatives. It is impossible to know which banks adhere to these policies and for which customers. The reporting of large transactions does not apply to customers who have an existing relationship with the bank. Nor does it apply to those customers recommended by "reputable" parties, a term that broadly encompasses law firms, accounting firms, and other professionals. Hence, it appears that it is still a relatively simple matter for narcotics traffickers and other criminals to establish a relationship with either a bank or a reputable third party.

Another method of penetrating Bahamian secrecy is via an order from a court of competent jurisdiction within the Bahamas. This provision has often been cited to PSI by the Bahamian Government—particularly the Attorney General—as an extremely effective means for U.S. law enforcement to overcome secrecy in order to gain evidence from Bahamian banks, trusts and companies. PSI was told that the Bahamas does not understand the "hard line" taken by U.S. law enforcement authorities toward the Bahamas as it is a "simple matter" to obtain Bahamian counsel, petition the Bahamian Supreme Court, and quickly obtain evidence requested.

Unfortunately, as the Attorney General of the Bahamas concedes, he cannot predict Bahamian courts' decisions on U.S. applications for disclosure. He stated further that requests for bank information needed in a United States civil tax case might be honored by the Bahamian courts. The Attorney General likewise expressed surprise that the United States has not made more requests for information from the Bahamian courts.[135]

On the other hand, PSI was told by Bahamian bankers and attorneys as well as United States law enforcement officials that, not only will the Bahamian courts refuse requests relating to tax matters (civil or criminal) but they also will require an indictment in the United States prior to granting a request for secrecy waivers. In fact the United States, in its brief before the Supreme Court regarding the Bank of Nova Scotia's petition for writ of certiorari, noted that the Bank of Nova Scotia itself showed in evidence presented to the lower courts that the Bahamian courts would not order production where the crime or the criminal activity was a tax crime.[136]

Since many investigations of major narcotics and other crimes involve tax charges as well as Title 18 or Title 21 charges, the Justice Department sees the Bahamian "no tax information" policy as a major bar to piercing bank secrecy on cases in which proceeds have been laundered through the Bahamas. Similarly, to require an indictment prior to the Bahamian court granting of disclosure moots the issue as in virtually all cases the information requested from the court is needed to develop the proof necessary to obtain an indictment.

These problems are further complicated by the ambiguity surrounding how requests to the Bahamian courts should be made. While PSI was told by the Attorney General that application should be made via Bahamian counsel to the court, the Department of Justice has been instructed that all such requests must be coordinated through the Bahamian Attorney General's office. PSI had been informed previously that any such request received at the Bahamian Attorney General's office would be rejected as it should go through private counsel in the Bahamas. Hence, prevailing policy is still a matter of uncertainty.

To counter these problems, the Justice Department has resorted to other methods to obtain data from the Bahamas. Lowell Jensen, Department of Justice Assistant Attorney General, explained these methods in subcommittee testimony:

> Where problem bank secrecy jurisdictions fail to reach a reasonable accommodation between bank secrecy and the requirements of bona fide reasonable law enforcement interests, other measures will be aggressively pursued: First, we shall be obligated to resort to the service of subpoenas on the United States branches of banks whose foreign records we seek. This approach was most recently sanctioned by the United States Court of Appeals for the Eleventh Circuit in *United States* v. *Bank of Nova Scotia,* 691 F.2d 1384 (11th Cir. 1982). Second, we shall, after careful review by Department of Justice officials in Washington, D.C., subpoena appropriate officers of foreign banks if they enter the United States where they are concluded to be material witnesses. See, *United States* v. *Field,* 532 F.2d

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[135] April 22, 1982 interview with the Bahamian Attorney General by PSI staff.

[136] Brief for the United States in opposition to the Bank of Nova Scotia's petition for a writ of Certiorari to the United States Court of Appeals for the 11th Circuit, October term 1982, p. 15.

> 404 (5th Cir. 1976). Third, we shall, applying comparable standards and review within the Department, subpoena attorneys and agents for foreign corporations who travel into the United States involved in money laundering schemes to testify and to produce records of the corporations. *United States* v. *Bowe,* 694 F.2d 1256 (11th Cir. 1982).
>
> Until we can obtain the level of cooperation from other bank secrecy jurisdictions which we have obtained from the Swiss and certain other countries, foreign bank secrecy laws will enable criminals to successfully avoid indictment and prosecution in the United States. The problem presented by the use of banks in such bank secrecy jurisdictions is particularly acute in connection with financial investigations of high level narcotics traffickers and financiers who use banks in such jurisdictions to launder the astronomical profits they make from preying on our society. Many narcotics financial investigations have been frustrated by the invocation of bank secrecy laws. Such use of bank secrecy laws plainly frustrates law enforcement agencies which seek only to protect the public from such criminals and thus, unreasonable bank secrecy should not be tolerated by the international community.[137]

The Bahamian Government and the U.S. Justice Department have been engaged in a dialogue on these issues since 1980. During this period, the Bahamian Central Bank revoked the license of Colombus Trust, a trust implicated in several large money laundering cases in the United States. Also, suspension of another bank's license seemed imminent in 1983 due to its involvement in a Bahamian scandal. The Central Bank stated it planned to take action against this second bank, because the bank was acting in a way that was "detrimental to The Bahamas".[138]

U.S. and Bahamian negotiations regarding implementation of bank secrecy provisions have recently been interrupted by two significant events. On November 29, 1982, the Eleventh Circuit Court of Appeals upheld a civil contempt citation against the Bank of Nova Scotia for failing to produce documents from the Bahamas in compliance with a United States court subpoena (*Bank of Nova Scotia* v. *United States,* 691 F.2d 1384 (11th Cir. 1982), *cert. denied,* 1053 S.Ct. 3086 (1983). Certiorari was subsequently denied, stiff daily fines were imposed, and the Bank finally produced the documents subpoenaed. The Bahamian government attacked the Justice Department's approach in the Bank of Nova Scotia case as a violation of Bahamian sovereignty. The Bahamian position is that the Justice Department should have made application to the Bahamian courts for the documents at issue.

The potential ripple effects of this *Nova Scotia* case as well as another involving its Cayman Island branch are enormous. The records sought were probably discoverable via letters rogatory but the Justice Department by-passed the Bahamian court system and thus indicated that Bahamian assistance was not necessary or would not achieve a positive result. Hence, the message: U.S. pressure could continually force international banks to comply with subpoenas.

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[137] Hearings, pages 219-220.

[138] Interview with Central Bank authorities by PSI staff, September 1, 1983.

Bilateral relations have been further complicated by a September 5, 1983, U.S. television news report alleging that financial fugitive Robert Vesco had made payoffs to the Bahamian Prime Minister and other top officials to ensure their cooperation in a drug operation involving Vesco and Carlos Lehder, a known Colombian cocaine dealer. The shock waves of these allegations are still being felt, as judged by the daily reports in the Bahamian press. In any case, the furor over the alleged drug payments together with the *Nova Scotia* case has effectively halted the U.S./Bahamian dialogue on bank secrecy—at least temporarily.

On October 17, 1983, Attorney General Paul Adderly attacked the *Nova Scotia* decision and defended the right of the Bahamians to follow its common law secrecy tradition:

> (W)e have had, in our own national interest, to respond in self-defense against an assault of a peculiar nature which we believe rightly could have an adverse effect upon The Bahamas, upon its banks and the thousands of Bahamians employed in the banking service industry.[139]

These attacks were continued in June 1984 by the Prime Minister in a prepared statement he gave before the Royal Commission of Inquiry established to investigate the NBC News allegations. In his statement, the Prime Minister accused the U.S. of initiating a campaign of lies and disinformation designed to embarrass the Bahamas because of its stance on bank secrecy. The Commission had heard evidence from over 300 witnesses from January to July 1984 when the Prime Minister testified. Its final report was issued in December 1984.

Thus, official Bahamian defensiveness over the "offshore crime problem" may portend additional headaches for law enforcement personnel eager to put these problems aside and enter into some type of information exchange agreement. Whether or not U.S. law enforcement authorities will be able to continue to extract information from Bahamian banks via the Bahamian courts remains to be seen, but there is no question that investigations and prosecutions will continue with or without Bahamian cooperation. This fact alone renders it essential that the Bahamian government and the U.S. government return to their dialogue at the earliest possible date. The issues of Bahamian sovereignity and U.S. law enforcement efforts are not mutually exclusive and should not be ignored.

BARBADOS

Barbados, located 270 miles northwest of Venezuela, is one of the most developed of the eastern Caribbean islands and has been able to maintain a sound economic system and political stability. Tourism still earns the most foreign exchange, but manufacturing has surpassed it in terms of becoming the most important economic sector. Sugar production, which had once been the mainstay of the economy, has declined in recent years due to bad weather and difficulties in securing labor to work in the fields (even though the unemployment rate remains at 15%). Barbados has had, and continues to have, balance of payment difficulties and remains dependent on imports. The island is a self-governing state within the British Commonwealth, having gained its independence in 1966.[140] Barbados is the leader (along with Jamaica) in the Caribbean in trying to establish good trade relations and has endorsed the idea of an information exchange arrangement with the U.S. Certainly Barbados is the informal leader of CARICOM. One indication of this leadership position is the fact that Barbados has had a police academy for almost a century at which many of the police forces in the Caribbean are trained. It also served as a partial staging area for the 1983 invasion of Grenada by United States and CARICOM forces.

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[139] *Nassau Tribune*, October 18, 1983.

The current administration led by Prime Minister J.M.G.M. "Tom" Adams, has promoted offshore banking and the use of offshore companies since 1976. Barbados became a true servicing tax haven in 1977 when the International Business Companies Act of 1965 was amended so that an exempted company trading in Barbados for services "originating in Barbados for or on account of persons resident outside of Barbados and the other countries of the Caribbean community now may be completely exempt from the 45% income tax if it is not an international investment company." [141] Under this act, an international business company is defined as a corporate body in which (1) not more than 10% of the assets on liquidation would be receivable by individuals who are residents of Barbados; (2) not more than 10% of the share or loan capital is held by individuals who are residents of Barbados; and (3) the company elects not to receive credit in Barbados for foreign income taxes levied on the foreign income.[142] A foreign tax of only 1 to 2½ percent as determined by the Commissioner of Inland Revenue is levied on the earnings of Barbados banks derived from offshore activities.[143]

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[140] *Foreign Economic Trends and their Economic Implications for the United States-Barbados,* Washington, D.C.: (U.S. Department of Commerce, 1983), pp. 3–5.

[141] Walter H. Diamond, *Tax Havens of the World:* Barbados, New York: (Matthew Bender, 1974–1983) p.1.

[142] Ibid.

In the pamphlet, *Offshore Banking in Barbados—Information to Prospective Applicants,* (Central Bank of Barbados, Bridgetown, April 1981, p. 3), an eligible company and a qualified foreign bank are summarized as:

> (a) An eligible company must be locally incorporated, its activities restricted to offshore banking and at least one of its directors a resident and citizen of Barbados. For a non-resident controlled company the authorized capital is BDS $2,000,000, of which BDS$1,000,000, must be paid up in cash: for a resident of a controlled company the authorized capital is BDS$5,000,000 of which BDS$250,000 is paid up in cash.
>
> (b) A qualified foreign bank is a foreign bank licensed under the Banking Act at the time the Offshore Banking Act commenced; or which was not so licensed after the commencement of this Act and which has a prescribed minimum capitalization and assets; or a financial institution, approved by the Central Bank, that is directly or indirectly a wholly owned foreign subsidiary within the meaning of Section 12(6) of a foreign bank.

[143] *Diamond Tax Havens,* p.3.

Diamond states:

> Under the revised act, dividends paid out of profits or gains by international business, companies to other international business companies. The dividends qualify for the reduced rates of 2½ percent up to 10,000,000 Barbados dollars ($50,000,000.) decreasing to 1% over 30,000,000 Barbados dollars ($15,000,000.) if the dividends are received by international investment companies. Despite its success in attracting exempt companies since the revised

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The Offshore Banking Act (1979-26) sets forth the regulations under which an offshore bank may operate. An offshore bank can only operate with a license issued by the Minister of Finance, the Memorandum and Articles of Association must be acceptable to the Central Bank, and one director must be a Barbados resident. When an application for a license is received, the Minister of Finance begins an investigation into the financial status, history, character, adequacy of capital, earning prospects, etc., of the applicant. The annual license fee is Barbados $25,000 (U.S. $12,500). The same fee applies to the initial license. A quarterly statement of assets and liabilities must be submitted to the Central Bank. The full and correct names of the directors of the licensee must be submitted to the Central Bank, but according to offshore tax expert Walter Diamond, the Central Bank does not require any information on nonresident customers.[144] Section 102 of the Offshore Act, consistent with the International Business Companies Act, provides for tax exemptions in which there will only be a 1 to 2½ percent tax on profits and gains but no other capital gains, income tax or other direct tax levied in Barbados on profits made from offshore banking done within Barbados.

The provisions of the Offshore Banking Act which impose secrecy are sections 47 and 55. Section 47 states that "information concerning the identity of a depositor, settlor or beneficiary of a trust, or concerning the assets, liabilities, transactions or other information in respect of a depositor, settlor or beneficiary of a trust" acquired by "a director, officer, employee or auditor of the licenses" or "an employee of the Central Bank shall not (be disclosed) to any person except (under the limited circumstances provided) under subsection (2)."

The other secrecy provision, section 55, circumscribes the information obtainable by an examiner. It provides:

> An examiner may not have access to, nor shall be given access to, the name of any settlor or beneficiary of a trust, if the deposit agreement or instrument creating the trust, as the case may be, has directed that it be kept secret and the depositor, settlor or beneficiary is not a resident of Barbados.

Notwithstanding section 55, on the application of the Central Bank, the High Court may order the production of protected information. To do so, the court must be satisfied that the information "is required in the public interest by the examiner for the proper performance of his functions" and that "there are no other lawful means of acquiring the information."

In addition the act does not compromise the power of the examiner when the information is properly obtainable. Section 57 of the act provides that if properly obtainable information is not released to the examiner "the licensee is guilty of an offense and subject to

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act became effective, some United States attorneys have criticized the international business company law as being somewhat nebulous and the Central Bank commission has recommended that some clarification be issued.

[144] Ibid., pp. 4-5.

a fine of $5,000" and, to an additional "fine of $500 for each day during which the offense continues."

The Central Bank of Barbados is one of the strongest financial institutions of the Caribbean and provides many supervisory functions for the island's banking system which include "adopting necessary actions to ensure adequate levels of foreign exchange reserves, issuing of notes in circulation, offering of rediscount facilities for lending to manufacturing, tourism, agriculture and export trade, fixing of commercial bank reserves and guiding banks' activities and operating the Government's export credit insurance system.[145]

In addition, offshore banks are exempt from exchange controls and there are numerous income tax treaties avoiding double taxation. A captive insurance law was passed in 1983 which provides for easy transfer of funds and for secrecy, and Barbados hosted a conference on the world-wide insurance industry in November 1983.

Staff members of S. Cass Weiland and Charles Morley met with Barbadian officials and representatives both in Barbados and Washington in order to clarify offshore banking issues. There has been much concern in Barbados over the Treasury Department's cancellation of the 1945 U.K.-U.S. Double Taxation Treaty. Barbadian Ambassador Peter Liauri stated that the cancellation of the Treaty would create a significant psychological impact with respect to companies planning on investing in Barbados. He also mentioned Prime Minister Adams may very well take a hard line reaction to the cancellation and cease the cooperative efforts with the United States with regard to disclosure of information. It was also noted that Article 26 of the Double Taxation Treaty provided for an exchange of information between Barbados and the United States. When the treaty cancellation took effect January 1, 1984, this exchange provision was rescinded. Barbados therefore must refer back to common law with respect to making information in Barbados accessible to U.S. law enforcement.

In a separate interview, a senior attorney, in Barbados, who has promoted strict controls over offshore banking, felt that it was "savage" of the United States to strike the treaty when Barbados has been very responsible in its promotion of offshore banking. Barbados has a large number of well-educated, white-collar workers who are unemployed and it is hoped that offshore banking will assist these people to find employment in line with their skills and education. The attorney noted that Barbados has approximately 150 offshore businesses, about 75 of which have lost their attractiveness due to the treaty being revoked.[146] This opinion was echoed in an April 9, 1984 Wall Street Journal special advertising section on Barbados. The article noted that at the end of 1982, Barbados had 153 international business companies with an additional 90 registered from January through June 1983. The article stated that . . . "Although interest continues to be shown, it is felt that some of the interest is likely to wane because of a decision taken by the U.S. government to terminate the U.S./U.K. double taxation treaty . . ."

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[145] Ibid., p. 19.

[146] PSI staff interview in Barbados.

A Barbados banker agreed that there are only 150 offshore corporations in Barbados and only three offshore banks: Barclays Bank International, Ltd., the Royal Bank of Canada (Barbardos, Ltd.), and Barbados International Bank and Trust Co. Ltd. He said that the Banking Act gives the Prime Minister the ability to obtain all pertinent information from the Central Bank; therefore, U.S. law enforcement could apply to the Central Bank for disclosure via a letter of request.

The Prime Minister in a November 1981 speech summarized what appears to be the continuing Barbados approach: "Our philosophy for tax haven development has . . . been predicated on low taxation rather than no taxation. . . . Our slow start in attracting offshore banking business reflects our emphasis on quality . . . we are determined that only institutions of the highest integrity are licensed to operate from our shores." [147] In the interim, the Permanent Financial Secretary, Mr. Griffith, indicated that he believes that offshore operations are currently extremely limited and revenues to Barbados are negligible as a percent of their total income, generating less than $1 million (U.S. $500,000). According to Mr. Griffith, the government would be very responsive to U.S. requests for information as they do not want a tarnished image and he finds it unlikely that they would resist U.S. inquiries into a legitimate investigation.[148]

BERMUDA

Bermuda is a British colony located 570 miles east of Cape Hatteras. The population of 72,000 has a literacy rate of virtually 100%. The GNP for 1980 was $598 million and the people have a high standard of living with an $11,000 per capita income. In Bermuda, the unemployment rate is only 2% and economic growth has been steady, averaging 3.4% from 1977 to 1981. Bermuda has had a Governor appointed by the Crown since 1685 and it is the oldest British colony with a House of Assembly elected by the people. The nation gained wide self-determination in the conduct of local affairs through a new constitution which went into effect in 1968 and was amended in 1973. Tourism is the leading economic activity in Bermuda and accounts for over half of the GNP and foreign exchange earnings. Over 600,000 tourists visit Bermuda annually and the Government has promoted a concerted advertising campaign to encourage American and European financial and trading groups to use Bermuda as a convention site.[149] Bermuda hopes to take advantage of the U.S. Caribbean Basin Initiative which allows Americans to take tax deductions for conventions held in Basin locations if that jurisdiction has an exchange of information agreement. Unfortunately, this exchange of information is perceived as posing a major problem to the offshore industry.

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[147] Prime Minister's Speech to Third Caribbean Seminar of the International Tax Planning Association, November 9, 1981.

[148] PSI staff interview in Barbados.

[149] *Caribbean Databook,* Caribbean Central American Action, Washington, DC: 1983, pp. 53-57. Walter H. Diamond, *Tax Havens of the World:* Bermuda, New York: (Matthew Bender, 1974-1983) pp. 1, 13, 14, 20, 21.

Indeed, the second largest industry and earner of foreign exchange is offshore companies. More than 5,000 registered offshore companies bring in at least $200 million worth of foreign exchange annually. Most companies are owned by U.S. parents which are responsible for 65% of the investment from abroad. Bermuda's popularity with Americans is due to its proximity to the United States and the freedom from most local taxes. The island has excellent international air facilities and first rate telex and telephone service.[150]

In staff interviews Bermudians stated assiduously that they will not act to jeopardize their relationship with the United States because it is recognized as fundamental to their nation's success and defense. Accordingly, Bermudians claim that every effort is made to prevent use of Bermuda facilities by criminals.

On the other hand, Bermuda, like all tax havens, does not intend to police other States' tax laws. Bermuda has no criminal law governing tax minimization and will not supply confidential information relevant to tax evasion cases under investigation by other nations. Bermudians with whom PSI staff spoke insisted that Bermuda will not conform itself to U.S. demands for exchange information on tax matters, for this would jeopardize the offshore financial industry so important to the country. These conditions make it unlikely that Bermuda will participate in the Caribbean Basin Initiative.

There are about 5,500 exempt (offshore) trading companies including insurance and personal investment companies registered on the island.[151] Exempt companies must have a local registered agent, must be audited and directors are held responsible for diligence in supervision. Management of personal investment companies is also local, although beneficial ownership is foreign. The authorities in Bermuda estimate that most such owners are British or U.S. citizens.[152]

Bermuda has no criminal secrecy law. Confidentiality stems from common laws and the statutes governing how companies are formed. While bearer shares are not allowed in those non-exempt companies which hold interests in local Bermuda businesses, they are allowed for offshore, exempt companies. Nominees may hold shares on behalf of third parties, and both banks and law firms act in this capacity. Holders are required to have personal knowledge of those beneficial owners on whose behalf shares are held. The monetary authority must be notified of changes in beneficial ownership. In the case of shares in Bermudian entities, if a bank does act as a nominee, the shares must be physically held by the bank itself which holds them in the name of the real owner.[153]

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[150] Diamond, *Tax Havens*, p. 14. The insurance industry has traditionally been very important. There now exist approximately 850 captive insurance companies which generate $4.5 billion in annual premium income. Bermudians help and encourage the insurance business in the hope that drug money and other criminal activities will not become economic pillars as they have in some of the other Caribbean islands. John W. Dizard, "Danger Signals For Bermuda's Happy Captives" *Fortune*, January 23, 1984, p. 155.

[151] PSI staff interview in Bermuda, April, 1982.

[152] Ibid.

[153] Ibid.

The monetary authority maintains identifying data on all applicants for exempt companies.[154] The authority cannot disclose these names of beneficial owners of record without a court order. Furthermore, the authority's policy is to require such applicants to be recommended by well-known foreign banks or other institutions. Small private bank references are not acceptable, for the authority is aware that the applicant may himself be the concealed owner of the recommending bank.

In summary, although Bermuda is a significant tax haven it is not considered a significant repository for dirty money and its law enforcement authorities seem particularly diligent.

THE CAYMAN ISLANDS

The Cayman Islands is a British colony with a population of about 17,000 which consists of three islands located 460 miles southwest of Miami. The capital, Georgetown, is located on the largest island, Grand Cayman, and houses the government which is made up of a Governor, an Executive Council and a Legislative Assembly. The economy has grown substantially during the last decade with the greatest development occurring in tourism, real estate, and banking and financial business, with international finance operations playing a major role. In addition, the Caymans are a major locale for offshore insurance companies.[155] Reasons for general economic growth include reliable transportation and communication services and a stable political environment. Reasons for banking growth include: (1) no income, corporate or property tax; (2) no tax treaty obligations or government exchanges of tax information; (3) the abolition of all forms of exchange control, making the country a currency free port; and (4) the requirement that only one of a bank's directors need have any substantial banking experience. By 1981, more banks per capita were located in Georgetown than any other city in the world.[156] In fact, by 1981 the Caymans had 30 licensed commercial banks (Type A), over 300 brass plate banks which are only allowed to conduct offshore business (Type B), and approximately 13,500 corporations (which can be used as fronts for illegal operations).[157] By 1984 the figures were reported to be 450 banks and 18,000 corporations.

Cayman secrecy is legendary but recent U.S. pressure and an apparently sincere government policy of avoiding drug money are bringing changes. Prior to 1984, however, the Caymans gave little indication of a willingness to cooperate. For example, during the subcommittee's hearings Assistant Attorney General Lowell Jensen described the lengths the Department of Justice went through to defeat Cayman government efforts to block access to bank records in the *Interconex* case. (See discussion, *infra.*) Senator Roth also questioned John M. Walker, Assistant Secretary, Department of Treasury, about the extent and the effect of the Cayman secrecy laws:

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[154] A bank itself may initially petition for a court order to protect itself against a depositor/client, for example in a case where the bank concludes that proceedings against the client are in order.

[155] *See* Product Liability Risk Retention Act of 1981, P.L. 97-45, A5 stat. 949 (1981). The Act permits the formation of product liability insurance cooperatives and is seen as a way to reduce insurance costs. The Act specifically permits such groups to be formed "under the laws of any State, Bermuda, or the Cayman Islands." (See 2(a)(4)).

[156] Richard B. Miller, "The Caymans—Offshore Banking Paradise," *The Bankers Magazine*, January/February 1981, p. 39.

[157] PSI Hearings, International Narcotics Trafficking, 1979, pp. 628–629.

> Chairman ROTH. In terms of ironclad secrecy, how would you rate the various havens? What are the most difficult ones to penetrate?
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> Mr. WALKER. I think that we would select a target or make a note of Panama, the Caymans, Netherland Antilles, I think to some extent, the Bahamas. These are all havens which we believe are utilized with quite some regularity by those who wish to make use of the tax havens for illegal purposes.
>
> Chairman ROTH. Do you think the Caribbean Initiative, which uses a carrot approach, would help solve this problem, substantially solve this problem or just have a minimal effect?
>
> Mr. WALKER. I do not think that it is going to solve the problem because I think that the bank secrecy requirements or bank secrecy laws, which operate in these countries are still remaining and will remain the principal obstacle to our being able to get the kind of information that we need.[158]

In 1959 the Caymans were transferred from a dependency of Jamaica to a colony of the United Kingdom and 7 years later bank secrecy was initiated by the enactment of the Banking and Trust Law of 1966. Section 10 of this law reads:

> 10. (1) Except for the purpose of the performance of his duties or the exercise of his functions under this law or when lawfully required to do so by any court of competent jurisdiction within the islands or under the provisions of any law of the islands, no person shall disclose any information relating to any application by any person under the provisions of this law or to the affairs of a licensee or of any customer of a licensee which he has acquired in the performance of his duties or the exercise of his functions under this law.
>
> (2) Whoever contravenes subsection (1) is guilty of an offense and liable on summary conviction to a fine not exceeding $2,000 or to a term of imprisonment not exceeding 1 year or both.

Hence, disclosure of bank information or a lack of confidentiality concerning banking matters is enforceable with criminal sanctions. But in the context of the act, this section applies only to government officials who acquire information relating to the affairs of a bank's customer preparing their audits or reports. It does not cover bank officers and employees.

In 1976 new secrecy legislation was enacted as a direct result of the Miami Federal district court's holding in *United States* v. *Field* which was unfavorable to the Caymans. *See* 532 F. 2d 404 (5th Cir. 1976). The Cayman legislature passed the Confidential Relationships (Preservation) law which transformed the previous bank secrecy law into a sweeping business secrecy law.[159]

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[158] Hearings, p. 41–42.

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[159] The Caymans have a Confidential Relationships (Preservation) Law dating from 1976, as amended in 1979. The relevant portions are as follows:

3.(1) This law has application to all confidential information with respect to business of a professional nature which arises in or is brought into the Islands and to all persons coming into possession of such information at any time thereafter whether they be within the jurisdiction or thereout.

"(2) This Law has no application to the seeking, divulging, or obtaining, of confidential information—

(a) in compliance with the directions of the grand Court pursuant to section 3A;

(b) by or to—

(i) any professional person acting in the normal course of business or with the consent, express or implied, of the relevant principal;

(ii) a constable of the rank of Inspector or above investigating an offense committed or alleged to have been committed within the jurisdiction;

(iii) a constable of the rank of Inspector or above, specifically authorized by the Governor in that behalf, investigating an offense committed or alleged to have been committed outside the Islands which offense, if committed in the Islands would be an offense against its laws; or

(iv) the Financial Secretary, the Inspector or, in relation to particular information specified by the Governor, such other person as the Governor may authorize;

(v) a bank in any proceedings, cause or matter when and to the extent to which it is reasonably necessary for the protection of the bank's interest, either as against its customers or as against third parties in respect of transactions of the bank for, or with, its customer;

(iv) the relevant professional person with the approval of the Financial Secretary when necessary for the protection of himself or any other person against crime; or

(c) in accordance with the provisions of this or any other Law."

3A.(1) Whenever a person intends or is required to give in evidence in, or in connection with, any proceeding being tried, inquired into or determined by any court, tribunal or other authority (whether within or without the Islands) any confidential information within the meaning of this Law, he shall before so doing apply for directions and any adjournment necessary for that purpose to be granted.

(2) Application for directions under subsection (1) shall be made to, and be heard and determined by, a Judge of the Grand Court sitting alone and in camera. At least seven days' notice of any such application shall be given to the Attorney General and, if the Judge so orders, to any person in the Islands who is a party to the proceedings in question. The Attorney General may appear as amicus curiae at the hearing of any such application and any party on whom notice has been served as aforesaid shall be entitled to be heard thereon, either personally or by counsel.

(3) Upon hearing an application under subsection (2) a Judge shall direct—

(a) that the evidence be given; or

(b) that the evidence shall not be given; or

(c) that the evidence be given subject to conditions which he may specify whereby the confidentiality of the information is safeguarded.

(4) In order to safeguard the confidentiality of a statement, answer or testimony ordered to be given under subsection (3)(c) a Judge may order—

(i) divulgence of the statement, answer or testimony to be restricted to certain named persons;

(ii) evidence to be taken in camera; and

(iii) reference to the names, addresses, and descriptions of any particular persons to be by alphabetic letters, numbers or symbols representing such persons the key to which shall be restricted to persons named by him.

(5) Every person receiving confidential information by operation of subsection (2) is as fully bound by the provisions of this Law as if such information had been entrusted to him in confidence by a principal.

(6) In considering what order to make under this section a Judge shall have regard to—

(a) whether such order would operate as a denial of the rights of any person in the enforcement of a just claim;

(b) any offer of compensation or indemnity made to any person desiring to enforce a claim by any person having an interest in the preservation of secrecy under this Law.

(c) in any criminal case, the requirements of the interests of justice.

(7) In this section, unless the context otherwise requires—

"court" bears the meaning ascribed to it in section 2 of the Evidence Law:

"given in evidence" and its cognates means make a statement, answer an interrogatory or testify during or for the purposes of any proceeding;

"proceeding" means any court proceeding, civil or criminal and includes a preliminary or interlocutory matter leading to or arising out of a proceeding.

4.(1) Subject to the provisions of sub-section (2) of section 3 whoever—

(a) being in possession of confidential information however obtained;

(i) divulges it; or

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By 1979, the confidentiality legislation was considered to have two major flaws. Its broad wording could have led Caymanian courts to void parts of it as being too vague. Furthermore, the law was expressly deemed to have "no application" to "any professional person acting in the normal course of business." International tax lawyer Marshal Langer, in the 1979 book *Practical Tax Planning,* wrote that "the extremely broad definition of 'professional persons' and 'normal course of business' might possibly have been construed to exonerate a banker, lawyer, or accountant who imparts information solely to government officials under compulsion."

Uncertainties over the scope of the act lead to a 1979 revision which set out procedures for banks or bank employees to follow when required to give evidence in a foreign proceeding: They must now notify their Attorney General and "apply for directions" from the Grand Court. In deciding whether the foreign order should be complied with, the court is to hear the Attorney General, if he appears, and to consider the following matters: "(a) whether such order could operate as a denial of the rights of any person in the enforcement of a just claim; (b) any offer of compensation or indemnity made to any person desiring to enforce a claim by any person having an interest in the preservation of secrecy under this law; (c) in any criminal case, the requirement of the interests of justice." As to the last point, it is doubtful whether tax evasion would even be recognized as a sufficient basis for an order direct-

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(ii) attempts, offers or threatens to divulge it to any person not entitled to possession thereof;

(b) wilfully obtains or attempts to obtain confidential information which he is not entitled, is guilty of an offense and liable on summary conviction to a fine not exceeding $5,000 or to imprisonment for a term not exceeding 2 years or both.

(2) Whoever commits an offense under sub-section (1) and receives or solicits on behalf of himself or another any reward for so doing is liable to double the penalty therein prescribed and to a further fine equal to the reward received and also to forfeiture of the reward.

(3) Whoever, being in possession of confidential information, clandestinely, or without the consent of the principal, makes use thereof for the benefit of himself or another is guilty of an offense and on summary conviction liable to the penalty prescribed in sub-section (2) and for that purpose any profit accruing to any person out of any relevant transaction shall be regarded as a reward.

(4) Whoever being a professional person, entrusted as such with confidential information, the subject of the offense, commits an offense under subsections (1), (2) of (3) is liable to double the penalty therein prescribed.

(5) For the removal of doubt it is declared that, subject to subsection (2) of section 3, a Bank which gives a credit reference in respect of a customer without first receiving the authorization of that customer is guilty of an offense under subsections (1) and (4).

5. Nothing in this Law shall by implication be deemed to derogate from the rule in *Tournier* v. *National Provincial and Union Bank of England.* (1924) 1KB, 416 (which deals with the civil duty of banks to preserve the confidentialty of the business to their customer) which rule is declared to have application to the Islands.

6. The Governor may make regulations for the administation of this Law.

7. No prosecution shall be instituted under this law without the consent of the Attorney General.

* * * * * * *

Passed the Legislative Assembly this 6th Day of September, 1979.

This Act extended the coverage of those prohibited from divulging information to bank employees, solicitors, government officials, and "every kind of commercial agent" and "every person subordinate to or in the employ or control of such person for the purpose of his professional activities". Confidential information was defined as "information concerning any property which the recipient thereof is not, otherwise than in the normal course of business, authorized by the principal to divulge." The misuse of confidential information is now "a criminal offense if committed in the islands and even if committed outside the islands in relation to Caymanian subject matter."

ing compliance. The Caymans do not impose an income tax and, therefore evasion is not a recognized crime.

Stephen Clarke, Senior Legal Specialist for the Library of Congress, who researched the issue for PSI, makes this observation about the 1979 amendments:

> Rather than having an automatic "blocking statute," bank secrecy can now be obtained under the law of the Cayman Islands only through a court order. A bank can no longer claim in a foreign proceeding that compliance with a court's request for evidence would be a *per se* violation of the bank secrecy law. Releasing confidential information, in and of itself, is not an offense under the 1979 amendments as it was intended to be under the 1976 act. The blanket duty of secrecy of the 1976 act has been replaced with a duty to seek judicial assistance and to comply with orders that are to be made on a case by case basis. Thus, a person having a Cayman Islands account, trust, or corporation, cannot be guaranteed that the law will offer any shield in any prosecution. On the other hand, the Grand Court would probably block any "fishing expeditions" or investigations where actual criminal charges have not been filed.[160]

This conclusion is debatable in part. An analysis of the act as amended indicates that *all* disclosures are prohibited unless authorized. A Cayman bank, when served with a U.S. subpoena, can still argue that Cayman secrecy prohibits disclosure but its failure to attempt to obtain a waiver through the Cayman court would no doubt fail to impress a U.S. judge.

As a result of these secrecy laws and their steadfast adherence by Cayman authorities, the islands have been an appealing location to deposit illegal money. During the subcommittee hearings, Chairman Roth and Robert D. Powis, Deputy Assistant Secretary for Enforcement of the Department of Treasury, discussed the relationship between currency transactions handled by non-U.S. entities and narcotics trafficking:

> Chairman ROTH. I would like to go back to CTR's. Some of the information we received from Treasury, with respect to currency transactions involving entities using non-U.S. addresses raises several questions.
>
> In 1981, these non-U.S. currency transactions totaled $8 billion. It is a rather large amount of currency. For instance, currency transactions from the Bahamas totaled $151.8 million, *from the Cayman Islands, $113.8 million*, from Colombia, $327.5 million, from Panama, $155.3 million,[161] from Switzerland $761.6 million. Can you shed any light on why we are seeing these extremely large currency transactions in these countries? . . . (emphasis added)

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[160] Analysis of bank secrecy laws prepared for the Subcommittee by Stephen F. Clarke, Senior Legal Specialist, Library of Congress.

[161] According to PSI analysis of deposits made by Banco National de Panama through the Federal Reserve in New York and Miami to the B&Ps account at the Bank of Boston, the currency transactions from Panama are over $1 billion, rather than $155.3 million.

> Mr. POWIS. Mr. Chairman, we believe what we are seeing here is more and more currency leaving the United States and going to the places that you mentioned in particular and then filtering back through. We believe that to a considerable extent it is a product of narcotics trafficking activity.[162]

In 1981, the subcommittee held hearings on international narcotics trafficking. At that time, S. Cass Weiland, chief counsel to the subcommittee, submitted testimony concerning the problem of U.S. currency entering Cayman banks. He stated:

> We asked how Cayman monitors its banks once they are established; for instance what happens when a businessman walks into a bank with a suitcase full of U.S. currency? The Caymanian officials told us the banks will inquire where the money came from since they do not wish to be associated with any dirty money, but the officials could not tell us exactly how they know this is done and what the mechanics are. The banks have no requirement to report specific transactions to Cayman regardless of their magnitude or nature. General annual reports or assets, etc., are all that is required. So in reality the government has no knowledge of bank transactions, nor do they seem to care. Other individuals have told the subcommittee that Caymanian banks accept any and all money without inquiry.[163]

Some changes have obviously occurred since 1981. Moreover, Cayman bank regulation has been somewhat effective since Cayman Class B banks do not have the reputation for fraudulent activity that plagues such banks elsewhere. That is, Cayman "paper" banks have not been the focus of a major scandal in recent years. It is the Class A commercial banks and Cayman companies which have traditionally created problems for law enforcement. In fact, the subcommittee notes the widespread continuing belief among U.S. law enforcement that Cayman Island banks accept suitcase currency as readily as any banks in the world.

Nonetheless, several recent cases and a new bilateral agreement have given U.S. prosecutors hope in helping to penetrate Cayman secrecy laws. In *United States* v. *Joseph Le Mire,* (the so-called *Interconex* case),[164] which involved a scheme to defraud Raytheon Company, records were sought by the Justice Department from certain Cayman banks after a September 1981 indictment in the District of Columbia. The U.S. Government filed a formal request under the Confidential Relationships Act with the Caymanian government. This request was handled by the Executive Committee of the Legislature (as delegated by the Governor) which authorized local police authorities to collect the records. At that point, Cayman banks refused to produce documents unless a court order was obtained and the Attorney General of the Caymans refused to represent the United States. Eventually, letters rogatory were drafted, local counsel was hired and the case was brought to a hearing before the Cayman Grand Court which promptly denied the request for judicial assistance. Thereafter, the United States took an appeal to the Cayman Court of Appeal sitting in Jamaica. This court overruled the lower court and granted the letters rogatory. Justice Department officials told the Senate in March 1983 that this was a landmark case and would stand as a "valuable precedent for future requests to Cayman courts for assistance in other United States prosecutions." [165]

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[162] Hearings, p. 43.

[163] PSI Hearings, International Narcotics Trafficking, p. 629.

[164] *U.S.* v. *Carver,* Crim. No. 81-00342 (D.C. 1981), *aff'd sub nom, U.S.* v. *Lemire,* No. 82-2492 (D.C. Cir., Nov. 4, 1983).

No doubt the case does serve as a valuable precedent. It does not, however, relieve the prosecutor or defense lawyer of the necessity of obtaining local counsel and proceeding in Cayman courts through a laborious letters rogatory process. Nor does the case totally override Cayman judicial discretion as manifested by the final decision by the court of appeals in Jamaica. It is problematical whether the Federal Government, much less a private litigant, will bear the expense of protracted proceedings in the Caymans with any regularity.[166] Moreover, the case involved a post-indictment situation and a crime, which unlike tax evasion, is not a purely fiscal one.

In the second case, U.S. Life Savings and Loan Association of Riverside, California sued Douglas Carlton and eight others for fraud after it traced Carlton's cash to the Bank of Nova Scotia in the Caymans. A California judge ordered the bank not to release any of Mr. Carlton's funds and the bank honored that order, perhaps based in part on the 1976 case, *United States* v. *Field,*[167] and the fact that it did not want to appear to be a tax haven for a controversial depositor.[168]

Indications are that U.S. patience with the Caymans is waning but the United States has almost no leverage over the islands other than strong arm subpoena power over some of her banks. The Caymans do not receive any economic aid from the United States that could be withdrawn. On the other hand the Caymans would like the United States to make several concessions, the effects of which would be very important to the economy. First, the Caymans would like to see a cessation of the practice of serving grand jury subpoenas on branches of Cayman Island banks in the United States. Second, although tourism is of paramount importance to the economy, flights are authorized to serve the Cayman Islands from only two American airports, Miami and Houston. Caymanian officials would like the authorization of more airports and more routes to service the Cayman Islands in order to increase tourism.

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[165] Hearings, p. 210 et seq.

[166] The Department of Justice may adhere to a "hawkish" position on the "protracted proceedings" issue. Deputy Assistant Attorney General Roger Olsen told the Wall Street Journal, "We're prefectly prepared to litigate it all the way up in every case." *Wall Street Journal*, January 11, 1983, at 12, column 1.

An interesting sidelight of the *Interconex* case was the award of substantial costs of prosecution by the trial court. It can be inferred that the defendants' tactics in resisting disclosure failed to impress the judge who awarded the Government some $200,000 in costs of prosecution.

[167] In the *U.S.* v. *Field* case, the court decided that a Cayman bank officer in the U.S. would have to answer grand jury questions about a customer's account, or risk contempt charges and the threat of arrest, even though the Cayman Bank Secrecy Act prohibits divulging information. As a case in point, in April 1982 a Cayman bank manager for Barclays was arrested in Florida as a material witness for a later scheduled trial.

[168] G. Christian Hill, "Caymans Case Shows How Courts in U.S. Are Cracking The Secrecy of Foreign Banks," *The Wall Street Journal*, October 14, 1982, p. 33.

Another issue involves the Caymans' only natural resource and major export, the green sea turtle. The turtle, which is indigenous to the Caymans, is on the Convention on International Trade in Endangered Species of Wild Fauna and Flora list of endangered species. The Endangered Species Act of 1973 prohibits commercial trading in sea turtles. In 1982 John McLean, representing the Cayman Islands Government, testified before the House Subcommittee on Fisheries and Wildlife Conservation and the Environment about this issue.[169]

The Caymanians contend that enough turtles are captive bred and raised on its unique turtle farm, that U.S. importation of captive bred farm turtles would not affect the wild population, and therefore the restriction should be lifted—at least to allow shipments through U.S. ports.

While the Cayman travel and turtle interests seem reasonable, one cannot ignore the U.S. enforcement temper. One IRS official estimated $3 billion criminal and $3 billion tax-evading moneys flow there annually; one Justice official estimated up to $10 billion illicitly flows there each year. Such figures are unsubstantiated, but many believe losses are high enough to justify strong reactions. Thus, it is hoped that Cayman authorities will see the near crisis nature of the present situation, where delay may lead frustrated tax officials to seek any type of sanction.

In the meantime demonstrations of U.S. resolve to overcome foreign secrecy legislation have probably damaged U.S.-Cayman relations as much as U.S.-Bahamas relations. In the past 2 years we have seen a Caymanian bank indicted in the United States (*United States* v. *Kilpatrick,* 575 F. Supp. 325 (D. Colo. 1983)), and recently, a Cayman banker arrested in Miami on a material witness warrant. In addition, the Cayman public and private sectors view with alarm the excrutiating *Bank of Nova Scotia* cases decided in 1983 and 1984 by the Eleventh Circuit. *See In Re Grand Jury Proceedings, U.S.* v. *Bank of Nova Scotia,* 722 F.2d 657 (11 Cir. 1983) and

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[169] House Subcommittee on Fisheries and Wildlife Conservation and the Environment Hearings, "Relation to the Endangered Species Act on Captive Propagation," October 4, 1982, p. 3. McLean stated:

> Before 1979, when the largest import ban took effect, the farm was the island's second largest employer, with a work force of over 90 persons. Now there are less than 20 working at the farm. In short, the ban has caused major damage to our economy.
>
> The farm is also a visible link to our turtling heritage and makes a crucial contribution to our sea turtle conservation program. Columbus called our islands "Las Tortugas" because of the large number of green sea turtles in our coastal waters. For generations, these turtles have been a source of protein for Caymanian people. However, the local populations of greens has become severely depleted.
>
> Thus, the advent of the farm's predecessor, Mariculture, Ltd., was welcomed as a means of assuring survival of the species in our islands and yet preserving the green sea turtle as a resource for future generations. This represents to us an almost perfect blending of Caymanian heritage with sound conservation management.
>
> Having the world's only green sea turtle farm has also enhanced our tourism. It is one of the main attractions for visitors to Grand Cayman.
>
> When the U.S. ban was imposed, the farm lost its major market. Until mid-1979, the United States represented about three-fourths of the farm's total sales. Moreover, prohibition of transshipment through the United States has also hurt the farm's ability to access other markets, especially in Europe and Japan.
>
> As a result, the farm has had to scale down its operation and the Cayman Islands Government has been forced to subsidize the farm's current expenditures. Without access to the U.S. market, the farm simply cannot survive.

691 F.2d 1384 (11th Cir. 1982). For some time, a superior method of handling the situation seemed to be a bilateral agreement of some sort, at least with respect to narcotics-related accounts. It was with great relief then that U.S., British and Cayman officials announced an agreement on July 26, 1984 which would give U.S. authorities access to information in drug cases in exchange for a U.S. pledge to cease issuing subpoenas to U.S. branches of Cayman banks. This agreement, however, does not extend to tax matters and it remains to be seen whether the extent of Cayman cooperation will equal the valuable subpoena tool the United States has agreed not to weld.

Essentially the agreement covers narcotics related documents located in the Cayman Islands. It provides for a certificate procedure whereby the U.S. Attorney General signs a request which is sent to the Cayman Attorney General. He, in turn, is empowered to simply issue a notice that the requested documents are to be produced. After reviewing, the documents are supposed to be promptly forwarded to the U.S. Attorney General. Authentication testimony is also provided for.

For its most part, the United States committed to foregoing enforcement of subpoenas for all Cayman documents within the scope of the agreement and also consented to an arrangement which would require Cayman government approval prior to using the documents in an unrelated proceeding. These are important concessions though doubtless necessary to achieve an agreement. Moreover the approval provision seems illogical since it applies even after the documents in question are made public in, e.g., a criminal trial. (See Section 6 and Annex of the exchange of letters between U.K. and U.S. concerning Cayman Islands, dated July 26, 1984). No doubt other jurisdictions with whom the U.S. is negotiating will seek similar concessions.

The respective governments have agreed to enter into negotiations for a comprehensive law enforcement treaty concerning criminal matters within 9 months if the narcotics agreement works satisfactorily. The negotiation of such a treaty would, indeed, be a remarkable achievement.

HONG KONG

Hong Kong is a British Crown Colony which occupies 400 square miles of the southern coast of the Republic of China. Its natural harbor and strategic location have made it a major world center for trading, manufacturing, and finance. The gross national product is approximately $26 billion (compare this figure with the United States' GNP of $3 trillion, Bahama's GNP of $800 million, and Panama's GNP of $4 billion).[170] Hong Kong has a population of about 5 million, approximately 98% of whom are Chinese. Although a British Colony until 1997, it is responsible for its internal affairs, including taxation, as is the case with other colonial havens such as the Cayman Islands and the Turks and Caicos. The British monarch appoints the Governor who is its chief executive and who presides over the Executive Council and consults with it on all important matters. He also presides over the Legislative Council which, through its Finance Committee, controls finance and expenditures.

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[170] *1983 World Bank Atlas,* Gross National Product, Population and Growth Rates.

Hong Kong Island and Kowloon Peninsula were ceded to Britain in perpetuity under two separate treaties during the mid-nineteenth century. The New Territories were leased from China in 1898 for 99 years. Since that time the colony has thrived under political stability, but its political as well as economic stability have been threatened by its future relationship with mainland China. The government of China stated that it did not honor the two treaties which ceded Hong Kong Island and Kowloon Peninsula to Britain, and that it planned to recover all of Hong Kong. In September 1982 preliminary discussions took place between British Prime Minister Margaret Thatcher and Chinese Prime Minister Ding Xiaoping, but no agreement was reached. After the diplomatic talks failed to clarify the future of the capitalistic colony, stocks dropped 21% on the Hong Kong stock market, the value of the Hong Kong dollar fell to $0.158, property values fell 25%, and a flight of capital out of the Colony began. It is estimated that $20 billion could leave in the next 15 years.[171] In April 1984, Jardine, Metheson & Co., the largest and oldest Hong Kong trading company which has extensive holdings in shipping, finance, and manufacturing, announced that it would be establishing a new parent holding company in Bermuda, because of the uncertainty surrounding the fate of the colony. Chairman of the company, Simon Keswick said he was worried about the type of legal system which will exist when the Chinese control the colony and stated, "We want to insure in the future that our holding companies have the ability to operate under British law." The day after Keswick announced the upcoming move, the Hang Seng stock market index plunged nearly 62 points.[172]

In 1984, Britain and China signed a draft agreement which outlined the terms under which Hong Kong will be turned over to China. According to the agreement, for 50 years after 1997, the legal and judicial systems will be maintained, the convertability of the Hong Kong dollar to other currencies will be insured as well as the freedom to move capital in and out of Hong Kong and the right of property ownership and free trade.

Hong Kong is a free port in that the government does not impose customs duties except for import duties on tobacco products, liquor, toilet preparations, medicines and hydrocarbon oils. Also, its fine harbor facilities, telecommunications and finance services enhance the export business. In 1981, exports were valued at $13.8 billion, imports at $23.7 billion and reexports (items shipped to Hong Kong and then exported elsewhere) at $6.6 billion. Due to the world-wide recession during 1982, exports dropped 2%, imports dropped 3%, and there was no growth in reexports.[173]

The normalization of diplomatic relations between the United States and the Republic of China has benefited Hong Kong in that the colony plays the role of the entrepot for trade between the U.S. and China. Over 600 U.S. corporations are located in Hong Kong which do business with China and the rest of Asia. China benefits from the Hong Kong port and foreign exchange because Hong Kong provides a connection between China and the rest of the world.[174]

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[171] "Hong Kong, Suitors are Swarming as Capital Takes Wing," *Business Week*, October 25, 1982, p. 49.

[172] Tom Nicholson, "A Fight from Hong Kong?" *Newsweek*, April 9, 1984, p. 84.

[173] Diamond, *Tax Havens*, p. 15.

Hong Kong's tax policies present advantages to the foreign investor. On February 25, 1982, Financial Secretary John Bremridge abolished all withholding interest tax on foreign currency deposits. During the next 3 months, bank deposits rose dramatically by 135% to $12 billion.[175] The previous 15% levy had sent most foreign (including the United States) funds to Singapore where foreign accounts are untaxed. Hong Kong bankers are now hopeful that Asian dollars will be diverted from the Singapore market to the Hong Kong market and that Hong Kong will capture Asia's offshore lending business.[176] Legislation enacted in 1967 authorized freedom from exchange restrictions, and there is no tax on capital gains. Hong Kong is not considered a true tax haven because it imposes a 16½% tax on corporate earnings whose source is within Hong Kong. The Inland Revenue Tax authorities attempt to determine where income is derived and, according to Barry Spitz, they generally try to establish "where in substance the operations which gave rise to the profits took place." [177] The Crown Colony does not have tax treaties which avoid double taxation with other countries because income not generated in Hong Kong is not taxed in Hong Kong.

In addition to the favorable tax policies, there exist other investment incentives in Hong Kong. The government does not believe in bureaucratic interference with commercial activity—there are no exchange restrictions or impediments to capital repatriation, and there are few import or export duties.

In *Tax Havens of the World,* Walter Diamond discusses the recent state of the banks:

> One hundred twenty-five licensed banks maintain 900 offices in Hong Kong and hold more than $11 billion in deposits. Many have branches and correspondents all over the world and are especially equipped to finance international trade. In addition to the licensed banks, which must have at least 10 million Hong Kong dollars ($1,580,000) of paid-up capital, there are 102 representative offices of foreign banks. Hong Kong is the third largest financial center after New York and London. . . . Because of the absence of a Central Bank and in view of the important role played by banks in commerce and industry, a Commissioner of Banking is appointed to exercise general supervision and control.

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[174] "Hong Kong", Background Notes—United States Department of State, December 1980, p. 4.

[175] Diamond, *Tax Havens,* p. 2.

[176] "Southeast Asia—Hong Kong's new bid for banking supremacy." *Business Week,* July 26, 1982, p. 33.

[177] Barry Spitz, *Tax Havens Encyclopedia: Hong Kong,* London Butterworths, 1975-1984, London, p. 24.

> After a 12-year moratorium on issuing licenses for new banks, in March of 1978 the Government announced it had decided to accept applications from "well established" foreign banks for banking licenses in Hong Kong. The objective in granting licenses to additional foreign banks was to "ensure that the financial sector was in a suitably competitive state." Forty-one banks were granted licenses and then a moratorium on new applications was resumed, starting in August 1979.
>
> Recent applicants for banks had to fulfill the following conditions: (1) be incorporated in countries where monetary authorities exercise effective supervision and have approved the establishment of a Hong Kong bank; (2) have total assets of more than $12 billion; and (3) provide some form of reciprocity in the applicant's country.[178]

Finance companies make up Hong Kong's secondary banking sector and play an important role in lending operations. Originally, finance companies were completely unregulated, although they carry out most bank functions except for the operation of checking accounts. In 1976 these 150 finance companies were required by the government to register under the Deposit-Taking Companies Ordinance which eventually imposed a few basic controls over them. By 1981, the government suspended registration of any new DTC's (except for those related to banks) because their numbers had escalated to 352 and their total assets over liabilities had grown to (H.K.) $244 billion. Their popularity was due mainly to the fact that they were offering a market rate of interest on deposits, which banks could not do because they had to accept the interest rates of the Exchange Banks Association.[179]

The extraordinary growth of banks and finance companies may be attributed in part to bank secrecy laws which are found in the nation's Banking Ordinance.[180] The criminal penalties for violating this law can be as high as a fine of $100,000 and up to 2 years imprisonment.[181]

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[178] Ibid., pp. 19-20.

[179] "Protect Depositors—or Let Jungle Law Prevail," *Far Eastern Economic Review*, March 17, 1983, p. 51.

[180] Chapter 155 of the Banking Ordinance states:

> 53. (1) Every person to whom this subsection applies—
>
> (a) shall preserve and aid in preserving secrecy with regard to all matters relating to the affairs of any person that may come to his knowledge in the exercise or performance of any function or duty under this Ordinance;
>
> (b) shall not communicate any such matter to any person other than the person to whom such matter relates; and (Amended, 84 of 1975, s. 6);
>
> (c) shall not suffer or permit any person to have access to any records in the possession, custody or control of any person to whom this subsection applies.
>
> except as may be necessary for the exercise or performance of such function or duty or for carrying into effect the provisions of this Ordinance. (Replaced, 65 of 1971, s. 3).
>
> (1A) Subsection (1) shall apply to—
>
> (a) any public officer;
>
> (b) any person authorized or employed by the Commission under section 4A;
>
> (c) any person appointed under section 13(1)(ii) or by order of the Governor in Council under section 14(1)(ii), to advise a bank in the proper conduct of its business;
>
> (d) any person who has assumed control of the business of a bank pursuant to a direction under section 13(1)(iii) or an order by the Governor in Council under section 14(1)(ii); and
>
> (e) any person employed by or assisting a person to whom this subsection applies by virtue of paragraph (b), (c) or (d), (Added, 84 of 1975, s. 6).
>
> who exercises or performs any function or duty under this Ordinance (Added, 65 of 1971, s. 3).

Because of the favorable tax policies and other business incentives, 88,000 registered companies were incorporated in Hong Kong as of 1981.[182] Over 600 companies are American and have investments totaling $1 billion. A corporation organized as a private company is able to conduct its business in maximum secrecy and does not have to file a copy of its annual report or financial accounts with the Registrar of Companies. If a company is not private, it is deemed public and must file a copy of its financial accounts with the Registrar of Companies [183] (which is open to the public for inspection), hold shareholders' meetings, and issue reports on allotment of shares as well as capital receipts and payments. Except for banking and insurance companies, a company does not need prior permission to incorporate; once incorporated it has perpetual existence. Company directors and shareholders may be of any nationality or residence. Even in public companies, corporate bodies and nominees are permitted to act as directors in order to maintain anonymity.[184]

Hong Kong's reputation for secrecy and anonymity has encouraged various scams, among them one involving George Tan and Carrian Group, his Hong Kong real estate conglomerate. Carrian was formed in 1980 with what appeared to be unlimited resources from mysteriously wealthy backers. Carrian quickly diversified into varied activities such as shipping, tourism, transportation and insurance. Among the many banks eager to offer credit was Bumiputra Malaysia Finance Ltd. (the Hong Kong subsidiary of Malaysia's government-owned Bank Bumiputra). Bumiputra Finance loaned Carrian $530 million; of that sum $230 million is now missing. This discovery was made when investigators examined the company's books after an officer of Bumiputra Finance was found strangled. Tan was arrested and charged with making false statements to creditors and investors.[185]

Recently, Hong Kong has shown interest in developing an exchange of information agreement with the United States. At least two sets of talks have been held. During the 1983 East Asia Regional Narcotics Conference, discussions included the suggestion that legislation be drafted in Hong Kong that would allow international drug enforcement agencies to examine personal bank accounts of suspected drug dealers who over the years have been attracted to Hong Kong's foreign exchange facilities, free enterprise system and sophisticated financial institutions. There exists the recurrent problem of how to draft legislation that would allow agencies to share information on tracing money flow without harming individual privacy and the Colony's banking system. U.S. officials would like to see laws enacted in every offshore banking haven, including

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[181] Laws of Hong Kong, Banking Ordinance, Chapter 155, § 53, 60.

[182] PSI Hearings, International Narcotics Trafficking, November 10, 12, 13, 17, and 18, 1981, exhibit no. 2, p. 42.

[183] Laws of Hong Kong, Companies Ordinance, Chapter 32. No criminal penalties are prescribed by the Companies Ordinance for breach of any secrecy regulations.

[184] Spitz, *Tax Havens Encyclopedia, Op. Cit.* note 177, p. 9.

[185] Louis Kraar, "How George Tan Duped His Bankers", *Fortune,* November 14, 1983, p. 119-120, and Frank Ching, "Carrian's Vast Network Unravels in Hong Kong", *The New York Times,* October 11, 1983, p. D1, D21.

Hong Kong, similar to those of Switzerland which, in the case of criminal involvement, permit access to numbered bank accounts.[186]

LIECHTENSTEIN

The Principality of Liechtenstein, one of the smallest countries in the world, covers 62 square miles (about the size of Washington, D.C.), and has a population of 26,000. It is a hereditary constitutional monarchy whose Chief of State has been Prince Josef II since 1938. The capital, Vaduz, is located near one of the oldest north-south transit routes in Central Europe. Since World War II, Liechtenstein has enjoyed political stability and economic prosperity which have encouraged the growth of industry, tourism and international banking. There exists a chronic labor shortage and foreigners must be imported to meet labor needs.[187]

Liechtenstein is one of the oldest tax havens in Europe. Walter Diamond writes of its history and relationship with Switzerland in *Tax Havens of the World:*

> Liechtenstein gained its reputation as one of the world's great tax sanctuaries shortly after World War I when, in 1923, the Principality signed a Customs Treaty with Switzerland. For more than 50 years the close link with the Swiss had guaranteed the Grand Duchy's position as an ideal European tax shelter, with the absence of taxation on income earned outside the Principality playing a major role. Liechtenstein and Switzerland are one economic unit, with similar tax and trade laws and with the Swiss franc the currency in Liechtenstein as well as Switzerland. The Grand Duchy benefits in many ways from the traditional strength of the Swiss franc, which has been regarded as one of the soundest currencies in the world for many decades. Liechtenstein also has identical legislation and regulations in the economic, customs and commercial areas as Switzerland. All of Switzerland's treaties of commerce and foreign exchange conventions apply equally to Liechtenstein.[188]

Due to its continuing political stability, liberal tax policies, and strict bank secrecy laws, there are now 62,000 holding companies located in the Principality which pay $3,000 a year in licensing fees. These companies are renowned for their "flexibility" and potential usefulness in various schemes. Consider, for example, the following cases:

> In *United States* v. *Kelly,* 349 F.2d 720 (2d Cir. 1965), Cecil V. Hagen, a petroleum attorney for Gulf Coast Leaseholds, Inc. (GCL) and John Van Allen, a businessman and representative of several Swiss trusts, were convicted of a stock fraud conspiracy involving the sale of millions of dol-

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[186] Vaudine England, "Law to Open Suspected Drugs Bank Accounts Under Study", *South China Morning Post,* December 1, 1983, pp. 1, 14.

[187] *Background Notes.—Liechtenstein,* U.S. Department of State, 1983, p. 1.

[188] Walter H. Diamond, "Tax Havens of The World: Liechtenstein," Matthew Bender, 1974-1983, New York, p. 2.

lars worth of unregistered common stock of GCL. Hagen and Roy B. Kelly, an attorney, in an attempt to obtain financing for GCL, met with Van Allen, a meeting which culminated in the purchase of a large block of GCL stock by the Brandel Trust, a Liechtenstein trust that Van Allen represented. As the agreement stipulated, the purchase was for "investment purposes" and not resale, the stock was not registered as required by Federal securities law. Van Allen, however, began selling huge quantities of stock immediately, in contravention of the investment pledge. All three defendants schemed to drive up prices and stimulate public demand for the stock. Hagen and Kelly allowed violations of the investment pledge, and authorized further stock transfers under similar terms, in return for kickbacks from Van Allen paid out of his Swiss trust, Sun Investment Co., into a Swiss trust created by him for Hagen and Kelly, called Universal Finance Company. Allegedly, over $1 million in profits and kickbacks were reaped at the expense of the public.

In *Bank Saderat (Iran)* v. *Marashi,* (Sup. Ct. GA. 1982), Iradj Marashi, former manager of Bank Saderat Iran's Los Angeles office, was charged with misappropriating $2.5 million in bank funds during the Iranian assets freeze in the United States. Marashi had convinced officials in Teheran that it was possible to circumvent the freeze by wiring funds for the Los Angeles office in personal drafts made out to him. The funds were actually deposited in his wife's U.S. bank account, then transferred to a private trust and to the Liechtensteinische Landesbank in Vaduz, Liechtenstein. Marashi was also charged with overriding loan officers in approving loans for several "shell" corporations, including a Liechtenstein corporation, and accepting fraudulent financial statements from borrowers without any effort to verify their accuracy.

In *United States* v. *Rittenberg,* Crim. No. 80-02565 (DCSD Cal 1980), defendants were charged with importing multitons of marijuana from Mexico into California through an intricate drug conspiracy. Illicit proceeds were laundered through various corporations formed in Liechtenstein, Switzerland and the Bahamas, then redistributed in the form of loans to the "clients" of these entities. Proceeds were actually reinvested in the operation and in property purchased with proceeds from the operation.

There are three banks in Liechtenstein: Liechtenstein Landesbank (National Bank of Liechtenstein), which acts as a central bank with an emphasis on saving and mortgage business. The bank in Liechtenstein A.G., which functions mainly as a commercial bank, and The Verwaltungs-und Privat-Bank AG (Private Trust Bank Corp.) which handles the usual banking, investment and management functions, but is oriented toward Switzerland. The three banks employ about 500 (5% of the total work force) and are members of the Swiss Bankers Association. Although the banks are important to the national economy, Dr. Emil Batliner states in *The*

Principality of Liechtenstein, "A mere three banks do not provide the basis for a financial center . . . Vaduz can be regarded as part of the international financial center constituted by Switzerland."[189]

The Banking Act of Liechtenstein is modeled on the Swiss example, but it is even stricter. Article 47 of the Bank and Savings Bank law of December 21, 1960, states:

> (1) Any person who intentionally
>
> a. As an auditor or an auditor's assistant grossly infringes his duties of auditing or the making or communicating his report, who fails to give the required notice to the bank being audited to take the necessary measures or who does not submit the prescribed reports to the banking commission (Articles 19 to 21).
>
> b. As an organ, officer, bank employee, auditor or auditor's aide, member of the banking commission, or officer or employee of its secretariat shall infringe the duty of secrecy or divulge a professional secret, or whoever induces one to do so, or attempts to induce another to do so, shall be punished for the offense by a fine up to 20,000 Francs or by imprisonment up to 6 months, or both.
>
> (2) When acting negligently, the perpetrator shall be punished for the offense by a fine up to 10,000 Francs.[190]

When foreign tax officials apply to Liechtenstein for information, the response is more conservative than that of Switzerland. During the Swiss bank scandal of 1977 it was estimated that $2 billion in fiduciary funds passed from the Swiss Credit Bank's Chiasso branch through a letter box corporation under Liechtenstein register called Texon Finanzastalt. In 1980 the Liechtenstein Parliament passed legislation intended to make reforms, such as the tightening of residency requirements for those representing foreign firms in Liechtenstein and the strengthening of supervision over financial transactions of holding, domiciliary and trust companies. Also, rules were to be tightened for the submission of financial reports and companies were to be audited annually. The object of these reforms was to eliminate corporate abuse, but the liberal basis on which a company may be founded still exists.[191]

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[189] Walter Kranz, ed., *The Principality of Liechtenstein*, Press and Information Office of Liechtenstein, 1981, p. 124.

[190] Translation from The German Liechtenstein Banks and Savings Bank Law of December 21, 1960, Article 47, Translated by Dr. George E. Glos, Assistant Chief, European Law Division, Law Library, Library of Congress, February 1983. In addition to bank secrecy legislation, the Liechtenstein State Defense Law of March 14, 1949 states at Article 4:

> Any person who discloses a manufacturing or a business secret in order to make it accessible to a foreign government agency or a foreign organization or a private entity or their agents,
>
> who makes a manufacturing or a business secret accessible to a foreign government agency or a foreign organization or a private entity or their agents,
>
> who denounces a citizen or a resident of the country to a foreign government agency or a foreign organization or a private entity or their agents because of his business activity.
>
> shall be guilty of a misdemeanor and shall be punished by imprisonment of up to three years, in serious cases shall be guilty of a felony and shall be punished by imprisonment of up to twenty years.
>
> In addition to imprisonment, a fine of up to twenty thousand francs may be imposed.

LUXEMBOURG

The Grand Duchy of Luxembourg covers 999-square miles, is a constitutional monarchy with the Grand Duke presiding as Chief of State, and is centrally located within the continent of Europe. It boasts an almost 100% employment rate, a high standard of living with a high per capita income, and a GDP in 1982 which was U.S. $4.8 billion. The production of steel has been the most important industry and employer, but with the decrease in the worldwide demand for steel, production decreased as much as 18% in 1981.[192]

International banking is the second most important aspect of the economy and is the second largest employer (5% of the labor force—7,500 people).[193] Luxembourg has been one of the fastest growing financial centers of the world, due in part to the pro-banking government policy, favorable banking and tax laws, freedom from income taxes, lack of exchange controls, and numbered bank accounts. It is a major Eurocurrency and Eurobond center and a home for many countries' offshore funds. Now the third largest banking center in Europe, it has 114 banks which include branches of most major United States, German, Norwegian, Finnish, Danish, Swedish, Belgian, Swiss and Soviet banks. In fact, the West Germans have established over 2 dozen subsidiaries in Luxembourg to avoid their own supervisory and monetary restrictions. The Luxembourg subsidiaries handle about 5% of the total German banking operations and 50% of foreign assets of German banks.[194] The German banks have contributed to the Grand Duchy's success as a financial center to such an extent that it is estimated they account for one-third to two-fifths of the Deutsche (German) mark Eurocurrency business.[195]

Luxembourg was involved in the near collapse of a private West German bank in late 1983. The private bank Schroder, Munchmeyer, Hengst (SMH) lent $346 million to the faltering IBH construction equipment concern, although it only had $42 million in capital. Much of the money was channeled through a Luxembourg subsidiary, thereby escaping scrutiny by West German authorities. Ultimately, German authorities created a consortium of 20 German banks that had to bail out SMH. West German regulators admit that a gap in reporting of the Luxembourg operations of German banks was responsible for their failure to be aware of the problem. Bankers are worried that this scandal, on top of the Ambrosiano scandal, will weaken confidence in the already troubled market. Euromarket lending by international banks has been undergoing a drastic slowdown. In the second quarter of 1983, there was no quarter-to-quarter growth in new lending for the first time in 20 years. On February 4, 1984, the West German Cabinet approved major changes in its banking law which would strengthen consolidation rules for foreign subsidiaries and limit the amount of a bank's lending to a single borrower.[196]

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[191] Barry Spitz, *Tax Havens Encyclopedia, Op. Cit.*, note 177, pp. 2, 3.

[192] *Foreign Economic Trends and Their Implications for the United States-Luxembourg,* U.S. Department of Commerce, 1982, p. 1.

[193] Stewart Fleming, "Banking Marks Time", *Europe,* January-February 1982, p. 35.

[194] Walter H. Diamond, *Tax Havens of the World: Luxembourg,* Volume 2, Matthew Bender, 1974-1983, New York, p. 16.

[195] Fleming, "Banking Marks Time", p. 34.

Applications from foreign banks are approved by the Luxembourg Banking Authority and bankers in Luxembourg handle the business of setting up holding companies, selling Eurobonds, and exporting and importing capital in unlimited amounts—in secrecy. Numbered bank accounts exist in Luxembourg on the same basis as they do in such countries as Switzerland or Singapore, and only the Commissioner of Bank Control can identify the depositors of numbered bank accounts.[197]

Luxembourg's Holding Company Act of July, 1929, exempts such companies from paying tax on income, interest on bonds issued, royalties, capital gains and on sales of shares or other assets and profits from sale of securities.[198]

Of other advantageous tax legislation in Luxembourg, Walter Diamond says:

> Because of its inability to negotiate many income tax treaties as a result of its small size, Luxembourg has taken another means of offsetting foreign withholding taxes. Under the 1978 Tax Act, taxes on income remitted from countries with which the Grand Duchy does not have a double taxation agreement and which are subject to tax in the country of origin may be deducted from the Luxembourg taxable base, provided there are enough profits available to pay the corporation tax.[199]

Tax treaties to avoid double taxation are held with the United States, the United Kingdom, the Netherlands, West Germany, France, Belgium, Austria, and Ireland (signed but not in force).

In addition to advantageous tax legislation, businesses are protected by certain types of financial secrecy. The section of the law on credit institutions which pertains to secrecy states:

> *Art. 16.* In derogation of article 458 of the Criminal Code, which prohibits administrators, members of the board of directors and the board of supervision, managers, and other employees of institutions referred to in article 1 of this law from revealing secrets confided to them in their capacity, persons who manage such institutions may disclose to any person who holds at least one-half of the capital or the funds of the institutions information concerning:
>
> > (a) the amount, the form, and the due date of loans granted to the debtor, if the total of the loans exceeds a certain amount or a coefficient with respect to certain elements in the institution's balance sheet;

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[196] "A Crisis at Schroder Jolts European Banking" *Businessweek*, November 21, 1983. "Bonn to Tighten Bank Lending Rules in Wake of SMH Crisis," *The Financial Times*, February 9, 1984, p. 1. "Germany's Whiz Kid Takes a Tumble", *Newsweek*, November 21, 1983, p. 86.

[197] Diamond, Tax Havens, p. 15.

[198] Ibid., pp. 1–2.

[199] Ibid., p. 6.

> (b) the amount, the form, and the due date of obligations toward another credit institution, if the total of these obligations exceeds a certain amount or a coefficient with respect to certain elements in the institution's balance sheet.
>
> The amounts of coefficients referred to in (a) and (b), as well as in the case the modality of the disclosure, shall be determined in a grandducal regulation.[200]

The following case examples illustrate how Luxembourg's status as a tax haven has been used to criminal advantage:

> In *the Texatron/Bell Helicopter* case, Bell (largest division of the Texatron conglomerate) allegedly paid millions of dollars to its sales agents to spur helicopter sales. The sales agents deposited the funds in secret accounts in Switzerland and Luxembourg on behalf of officials of the countries buying the helicopters—Ghana, Mexico, United Arab Emirates, Morroco, Ceylon, Iran, Indonesia, Dominican Republic, Iraq, and Colombia. The half-brother of the Shah of Iran received $616,700 from two bank accounts in Oklahoma City held by Air Taxi, Bell's onetime representative in Iran. The money was then deposited in a Swiss bank account.
>
> In *the Alvero Cruz* case, Jose Medardo Alvera Cruz, an alleged cocaine kingpin of Miami, was indicted in January 1980 for evading more than $3.5 million in U.S. currency in Madrid banks in 1975, another $1.8 million in 1976 and $1.3 million more in 1977—all of which was transferred to numbered accounts in Luxembourg, Liechtenstein, and Switzerland.
>
> In *United States* v. *Newman,* 664 F.2d 12 (1981), E. Jacques Cortois, employed by Morgan Stanley and Co., Inc., and Adrian Antoniu, employed by Kuhn Loeb and Co., misappropriated confidential information concerning proposed mergers and acquisitions that was entrusted to their employers by corporate clients. The information was conveyed to Newman, a securities trader and manager of a New York brokerage firm, who passed along the information to two foreign nationals. The three used secret foreign banks and trust accounts in Bermuda, Bahamas, Luxembourg and Switzerland to purchase the stock, and spread their purchases among the brokers to avoid detection. Once the mergers were publicly announced and the market price rose, they reaped substantial profits which they shared with Courtois and Antoni.

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[200] Translation from the French-Luxembourg, Law on Credit Institutions of April 23, 1981. Translated by Dr. George E. Glos, Assistant Chief, European Law Division, Law Library, Library of Congress, February 1983. Translation of the referred to Article 458 of the *Luxembourg Penal Code* follows:

> *Art. 458.* Physicians, surgeons, health officers, pharmacists, mid-wives and all other persons to whom, by reason of their position or profession, secrets have been confided, and who reveal such secrets in cases other than those in which they are called to testify in court and in those in which the law compels their disclosure, shall be punishable by imprisonment from eight days to six months and a fine from 100 to 500 francs.

Another more recent case involves possible tax evasion through a religious organization: According to ex-officials of the Church of Scientology, the reclusive founder, L. Ron Hubbard, set up a Liberian shell company to help transfer large amounts of church money to accounts in Luxembourg and Liechtenstein. The church's tax exempt operations are said to be under investigation in the United States, West Germany, Canada and elsewhere.[201]

MONTSERRAT

Montserrat, a small British colony in the Eastern Caribbean with a population of 12,000, entered the offshore banking arena with a different perspective than that of the Bahamas, Cayman Islands, or Panama. Montserrat is not a financial center, but it has recently become a haven for small, privately owned banks. As with several of its sister Caribbean countries, Montserrat entered the offshore banking business to raise revenues for a financially strapped government.

Montserrat does not have serious population, unemployment or inflation problems. Unemployment declined from 10.6 percent in 1977 to 5.4 percent in 1981 and inflation declined from 25 percent in 1979 to 7 percent in 1981.[202] The economy is nonetheless marginal, consisting of tourism, customs and excise taxes, property taxes, postage stamp sales, a very light assembly industry, and offshore banking.

In his April 15, 1982 budget speech, the Chief Minister of Montserrat gave some pertinent statistics to indicate the size and structure of the Montserratian economy. Revenues in 1981 totaled $7.28 million (U.S.)—representing a growth of 3.4 percent over the previous year. Revenues in 1982 were projected at $8.03 million (U.S.). Tourism is the largest source of foreign exchange bringing in $4.16 million (U.S.) in 1980 and $5.3 million (U.S.) in 1981.[203]

The licensing of offshore banks was a significant contributor to the Montserratian economy. In 1981, 62 offshore banks produced U.S. $492,000 in revenue. Revenues in 1982 were estimated to be U.S. $227,000 which was based upon the assumption that 30 offshore banks would renew their licenses.[204] Revenues from offshore banking further declined in 1983 with less than 12 banks producing approximately U.S. $114,000 in revenues.[205] This decline notwithstanding, the Chief Minister noted the importance of offshore banking to Montserratians when he stated that "the notable revenue improvement in 1981, as compared with 1980, was achieved without any new revenue measures; and no new measures are planned in 1982 either. Taxpayers will realize that this would scarcely be possible if we did not receive substantial revenue from offshore banking." [206]

But Montserrat's courtship with offshore banking has been brief. Though offshore banks have existed in Montserrat since the mid-

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[201] New York Times, Scientology Chief Got Millions, Ex-Aides Say, July 11, 1984, p. A1, 21.
[202] The Chief Minister of Montserrat's budget speech of April 15, 1982, page 3.
[203] Ibid., p. 29.
[204] Ibid., p. 5.
[205] August 22, 1983 Interview with Finance Minister of Montserrat conducted by PSI staff.
[206] Chief Minister's budget speech, pp. 5-6.

1970's, the industry did not become significant until 1980 when the WFI Corporation (a California entity) started forming Montserratian offshore banks. Documents submitted by Jerome Schneider, President of WFI, during his testimony before PSI on May 24, 1983, indicate that from 1980 through 1982, WFI formed 54 banks in Montserrat. All of these were subsequently sold by WFI to third parties.[207] Prior to his Senate testimony, Schneider told PSI staff that all of these banks were established by one of Montserrat's four attorneys. Before he began his wholesale business of selling bank licenses in Montserrat, Schneider met with Montserranian officials to promote his concept of Montserrat as an offshore banking center.[208] According to Montserrat's financial secretary, as of April 1982, the Montserratian attorney used by the WFI Corporation had established 50 of the 62 existing offshore banks on Montserrat. At least 45 of these 50 have been established on behalf of WFI clients.[209]

As previously noted in this report, one of these banks has recently received publicity due to the collapse of its parent bank in San Diego, California. J. David Dominelli formed the J. David & Co. investment and currency trading firm in 1979 which soon grew into a financial empire of over 50 companies in more than a dozen cities, employed 270 persons, and had approximately 1,200 customers. Dominelli requested minimum investments of $50,000 and claimed an average of 40 percent annual returns. These extremely high returns were credited to his acumen in trading foreign currencies on the international market. This practice is known as interbank currency arbitrage which is the simultaneous purchase of currencies in one market and their sale in another for a higher price. Most investors were content to receive a computer printout account statement from J. David and left their money in the accounts on the assumption that they were making a profit. In early January of 1984, investors were told that J. David was increasing its managing fees and requiring 10 working days for the withdrawal of funds. Many investors began withdrawal actions which resulted in bounced checks; Dominelli blamed this on Swiss banking employees for being unfamiliar with his system. The investors who started the run on the firm's accounts, and then were unable to cash out, filed suit in Federal court in February 1984, asking that the firm be declared bankrupt and liquidated under Chapter 7 of the Federal Bankruptcy Code. As early as 1984, the trustee had only recovered $582,500 of the $112 million said to be held in foreign banks, including the Montserrat based subsidiary J. David Banking (which reportedly was bought from Jerome Schneider for $35,000). Dominelli stated that more funds can be located in banks in Austria, Bermuda and Minnesota and additional funds are located in entities other than banks in London, Hong Kong, Guernsey, and Seattle. U.S. District Judge J. Lawrence Irving has said of the *Dominelli* case, "We've only seen the tip of the iceberg", and that the pending case could "result in full employment" for San Diego attorneys.[210]

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[207] Hearings, pp. 170-172.
[208] Ibid., pp. 194-196.
[209] PSI interview, April 27-30, 1982.
[210] Associated Press Wire Services, February 27, 1984-April 3, 1984.

In the meantime, the Government of Montserrat had already become concerned about the use and abuse of these offshore banks. It questions the validity of the background checks run by WFI on those perspective owners of Montserratian banks.[211] These same concerns were aired by Senator Rudman during Mr. Schneider's Senate testimony:

> Senator RUDMAN. Mr. Schneider, you have gone to great trouble to tell us about the screening process you go through.
>
> Do you want this subcommittee to get the impression that it is your view, as a sophisticated person with a sophisticated investment background, that a $500 or $1,000 investigation is going to in any way ensure absolutely that the wrong people won't get their hands on this license?
>
> Mr. SCHNEIDER. I don't think I could convince you or anybody of that.
>
> Senator RUDMAN. Can you convince yourself of that?
>
> Mr. SCHNEIDER. Yes; I can convince myself that it is helpful and I think I can convince you that it is better than nothing.
>
> Senator RUDMAN. I am not sure it is better than nothing.
>
> Let's go into the record of the people that you have licensed:
>
> Are you aware of the fact that the principals you deal with in some cases or in all cases could simply be agents for somebody else, are you aware of that?
>
> Mr. SCHNEIDER. Yes, sir . . . .
>
> Senator RUDMAN. Are you aware of the fact, with the exception of Pacific International, each of these people was interviewed, they were all agents, they may have no knowledge of how the banks are used by the principals, they went to you as an agent and immediately thereupon transferred ownership after you gave them the license which you owned, are you aware of that?
>
> Mr. SCHNEIDER. No; I am not aware of that.
>
> Senator RUDMAN. Can we agree for the purposes of the records, because we are building a record here, your process really doesn't work all that well, I can go through a lot more with you if you like and I am not criticizing you, I simply say if people lie to your face unless you have some powers the rest of us don't possess, you probably take them at their word absent some suspicious conduct, is that true?
>
> Mr. SCHNEIDER. Yes, sir. I would like to make a comment.
>
> Senator RUDMAN. Go right ahead.
>
> Mr. SCHNEIDER. You mentioned or I think Senator Roth mentioned the idea of regulating us, the persons who provide offshore banks to people.

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[211] Hearings, pp. 69–70.

> I think that might be a good idea. At least there might be some sort of a standard we can look to. We are unregulated now and we don't know—we are trying to operate a legitimate business in an environment of complex laws.
>
> I would be more than happy to file with the SEC or whomever to make certain our activities are in fact proper and above board. In fact, I am open to suggestion.
>
> If a staff of this subcommittee has any ideas how I can improve the background checking procedures of our business, I would be more than happy to initiate such recommendations.[212]

The concerns of Montserrat increased in 1981 and the government began to require that WFI disclose the names of the beneficial owners to whom it proposed to sell banks. By early 1982, WFI had ceased forming banks in Montserrat and shifted its efforts to the Pacific Basin, particularly the Northern Mariana Islands.

Montserratian efforts to clean up offshore banking industry are evident by the fact that there are now less than 12 offshore banks (from 62 in 1981) and that, as a matter of government policy, Montserrat will waive bank secrecy upon a "minimal showing".[213] Montserrat is also interested in negotiating a double taxation treaty with the United States since the U.S. Treasury has revoked the 1945 United States/British Treaty January 1984.

Montserrat appears to have removed itself from the offshore banking business as quickly as it became involved in it. The tightening of controls over the licensing of offshore banks and the Government's willingness to quickly cooperate with U.S. law enforcement with a minimal showing of need indicates that Montserrat can no longer be viewed as a jurisdiction where dirty money is welcome and safely hidden. These developments are encouraging and certainly in the long-term interests of both Montserrat and the United States.

THE NETHERLANDS ANTILLES

The Netherlands Antilles is comprised of 6 islands located off the coast of Venezuela which cover 394 square miles. The land is only 5% arable and contains virtually no natural resources. The population of 245,000 is concentrated mainly on the islands of Curacao and Aruba. In 1954, the islands were granted autonomy from the Netherlands and now, as a member of The Kingdom of the Netherlands, they have control over their domestic affairs. The economy is largely dependent on the operation of two oil refineries—Exxon's Lago Oil and Transport Company on Aruba and Shell's refinery on Curacao. These refineries import crude oil from Venezuela and the Middle East and then export refined petroleum products mainly to North America. After the oil industry became automated, unemployment rose to 23% by some estimates.[214] The free trade zones at Curacao and Aruba offer low freight charges, prompt service, and duty free goods imported from foreign countries and exported to foreign countries. The Antilles have excellent mail, telephone, telex and telegraph services. The second largest industry, tourism, is subject to seasonal employment and fluctuations in the political climate.

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[212] Ibid., pp. 187-190.

[213] August 22, 1983 interview with Finance Minister of Montserrat by PSI staff.

[214] PSI memorandum can be found in files of subcommittee.

The country's banking system provides local and international services and its Central Bank regulates the establishment and operation of new banks. It is estimated that over the past two decades, as many as 15,000 corporations—many with U.S. parents—have located in the Netherlands Antilles.[215] U.S. corporations, through their Antilles subsidiaries, raised $18 billion from the sale of Eurobonds (loans from overseas that can be tapped through London banks) from 1974 to 1981, $14 billion in 1982, and $2 billion during the first 3 weeks of 1983.[216] In financial jargon, this practice has been referred to as "going through the Antillian window". It was made possible by a legal loophole in the tax system whereby, according to the existing treaty between the two nations, U.S. corporations could avoid the 30% Federal withholding tax on interest payments made to foreigners. An example of this occurs when a U.S. corporation invests money in a Netherlands Antilles subsidiary which in turn borrows money from Europe. The subsidiary, which re-lends the money to the parent corporation, is only taxed by the Antilles on the net income from the transaction—a tax which can later be written off as a credit against U.S. taxes. In such a way, corporations can fund themselves efficiently by not subjecting their foreign investors to the withholding tax and at the same time avoid an adverse effect on their foreign tax credit limitation. The Commerce Department believes this type of foreign borrowing has contributed to the "mystery category"—undocumented money coming into the U.S. which causes government statistics to be inaccurate by approximately $25 billion per year.[217] Also, under the terms of this treaty, foreign investors in U.S. corporations or real estate could avoid Federal estate taxes by operating through an Antilles corporation.

According to the Netherlands Antilles government, tax revenues and foreign exchange earnings are the main benefits accrued from offshore operations. Over 1,000 people are directly employed and as many as 4,000 people are indirectly employed by the offshore industry—an important factor in a country where unemployment runs over 20%. But the economic health of the offshore business depends to a large degree on the treaty relationship between the Netherlands Antilles and the U.S.[218] By one estimate, the Antilles receives $100 million a year from its offshore tax revenues, which is one-third of its budget.[219]

The treaty which made all of this possible was the 1955 extension of the Netherlands Income Tax Treaty of 1948, as amended, and subsequently modified by Protocol of October 23, 1963. Because the United States believes the treaty has been abused by both foreigners and Americans, the United States, the Netherlands Antilles, and the Netherlands have been negotiating for 3 years over the treaty. The Treasury Department suggests that U.S. trading partners prefer to invest through the Antilles rather than to negotiate new tax treaties.

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[215] Fialka, John J. "Corporate Tax Haven In Netherlands Antilles Is Bracing for a Disaster," Wall Street Journal, October 11, 1982.

[216] "A Treaty That May Sink Havens," Business Week, February 14, 1983, p. 142.

[217] Fialka. Wall Street Journal, supra, footnote 215.

[218] Mathieson, John A. and Laudicina, Paul A., "The Netherlands Antilles: The Impact of Offshore Financial Activities." Prepared for the Government of the Netherlands Antilles, Embassy of the Netherlands, Washington, D.C, September 1982, pp. i-1.

[219] Bridges, Tyler, "Caribbean Tax Haven Faces Treasury Heat." People and Taxes, May 1983, p. 9.

The recently passed Tax Reduction Act of 1984 stands to at least partially draw the shades on the exclusivity of the Netherlands Antilles window. The law, reflecting as it does Congress' efforts to broaden the tax base and its sentiments that U.S. companies have been given overly generous tax incentives for foreign operations, relaxes the limitations on access to foreign sources of financing by domestic companies.[220]

New section 127(c)(1) repeals the 30% withholding tax on interest paid to certain foreign portfolio investors, including interest paid on corporate and U.S. Government Eurodollar securities. To mitigate the disruption of financing arrangements that have been used under favorable treaty provisions with countries such as the Netherlands Antilles, the measure applies only to debt obligations issued after the new law is enacted. For companies borrowing through an offshore finance subsidiary, there is a new measure which will cause the subsidiary distribution to be characterized as U.S. source income. As a result the foreign tax credit limitations of the parent company will be adversely affected.

In addition, the device of using a related foreign corporation to earn low taxed interest income abroad that, when repatriated, could be treated as dividend income (hence not subject to a separate limitation on foreign tax credit utilization) is now obsolete. Under the act, dividends of the foreign company will be treated as interest income, at least in part, if more than 10% of the payor corporation's income was interest income.

Of potentially great significance is section 127(i)(5) of the act. That section provides that the Secretary may, if "he determines that the exchange of information between the United States and a foreign country is inadequate to prevent evasion of the U.S. income taxes by U.S. persons" reimpose the 30% withholding tax. How this provision will effect the Netherlands Antilles is not known. The Netherlands Antilles does provide some barriers to obtaining information. For example, an Antilles company is able to issue stock in bearer shares that is not registered in the owner's name. There are no statutes that regulate bank secrecy specifically, but because of two articles in the Criminal Code, banks do refuse to divulge information concerning their clients.[221] It is uncertain, how-

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[220] See discussion in 59 Taxes International, 3-20 (Sept. 1984).

[221] Translation from "Wetboek van strafrecht voor de Kolonie Curacao" by Joyce Darilek, Senior Legal Specialist, European Law Division, Library of Congress, May 1982.

Translations of articles 285 and 286 of the Criminal Code follow:

Art. 285. 1. Whoever intentionally discloses any secret that he is obligated to keep by virtue of his present or previous office shall be punished by imprisonment up to 6 months or a fine up to 600 guilders.

2. If this crime is committed against a specific person, it shall be prosecuted only upon his complaint.

Art. 286. 1. Whoever intentionally discloses particulars where secrecy was imposed upon him concerning a commercial or industrial enterprise with which he is or was employed shall be punished by imprisonment up to 6 months or a fine up to 600 guilders.

Continued

ever, when, if ever, the authority granted to the Secretary under section 127(i)(5) will be used.

By eliminating much of the need for U.S. corporations to use offshore financial subsidiaries to borrow from the Eurodollar market, the 1984 act has important long-term implications for international transactions as a whole and the Netherlands Antilles in particular. While there is disagreement as to what types of changes the new act will bring about, or the ultimate effect it will have on the Antilles, there is little doubt that the act will diminish the Antillian offshore trade.

PANAMA

Panama, at "the crossroads of the world," has become a burgeoning financial center and one of the most important tax havens in the world. It is already the most important Eurobanking center for Latin America, and through its Colon Free Trade Zone, Panama handles an enormous amount of trade with Asia and Europe. The Colon Free Zone itself is said to be the second largest free trade zone in the world.

Panama's emerging financial center is crucially important to the government since significant light or heavy industrial growth is not anticipated. PSI staff was told that the financial industry directly employs 8,000 people and pays salaries of $60 million per year with considerable additional indirect support to building, technology, and other service industries. Measuring the relative sizes of banking systems is extremely difficult as noted elsewhere in this report. One set of figures, however, pegs the Panamanian banking system at about $41.8 billion, which places it well behind the Cayman Islands ($127.7 billion) and U.S. bank assets in the Bahamas ($136.3 billion).[222] It seems probable, however, that the Panamanian system is far larger and more important than these figures suggest. Panama also has the world's fifth largest registered merchant fleet (an offshore revenue device), and liberal reinsurance laws for its large offshore insurance industry.

Panamanian international banks are active in the Euromarket; thus, Eurocurrency transactions are available to the many Latin banks operating in Panama. With such a vital financial sector, Panama has been able to support its development through borrowings, a process which has been prudently managed, for although it has substantial debt, the country seems to have a good international credit standing.

In Panama, as elsewhere, the banking and business community heavily influences bank and company legislation and ethics, and has led the nation in an ambitious program of expansion aided directly and indirectly by the government and military. This expansion has brought the number of Panamanian banks to about 130, almost all of which are branches of established, legitimate international banks (for example, Chase Manhattan, Citibank, Bank of

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2. Whoever deliberately violates article 135, paragraph 2, of the Commercial Code shall receive the same punishment.

3. Prosecution shall take place only upon (receipt of) a complaint from the directors of the enterprise.

[222] These figures were supplied to the Subcommittee by the International Monetary Fund.

America, Scotiabank, The Bank of Tokyo, Banco Nationale de Paris, Credit Lyonnais and Swiss Bank Corporation). Panama City itself is booming as Asian, European and U.S. moneys flow through Panama for investment in Latin America. Meanwhile, goods in transit enter its free zone to be exported by distributorships throughout the world.

Special conditions make banking in Panama attractive. One is its ideal location; another is the security afforded by bank secrecy legislation and statutes which allow for the formation of secret registered companies. Fines can be imposed for disclosing information obtained from commercial documents to foreign authorities,[223] the investigation of the private affairs of a client of a bank is forbidden,[224] and the disclosure of information regarding the identity of a principal of a numbered bank account is against the law except in cases of criminal proceedings.[225]

Without question, the vast majority of Panamanians believe secrecy is essential to the survival of the country as a banking center, yet Panamanian bankers and government authorities insist they wish to avoid receipt of dirty money. Hence, two questions of great interest to the subcommittee are: What really accounts for the national preoccupation with secrecy and how much criminal capital is Panama attracting given its location along Colombian-U.S. drug routes? First, an analysis of Panama as a haven:

The distribution of assets in the banking system reflects Panama's attractions. Foremost in size are foreign corporate accounts; second are the accounts of foreign banks for interbank transactions in the Euromarket; third are funds from foreign national central banks (Latin, Caribbean and Central American, primarily); and least in amount are accounts of private investors.[226] Private accounts, which frequently take the form of registered company accounts, may also appear as interbank deposits, for it is common for registered companies from other havens such as the Bahamas or Caymans to hold their funds in the name of accounts of banks in those jurisdictions on deposit in Panama.[227] Thus, while financial authorities state that only 20 percent of accounts throughout the system are private, the figure may in reality be larger.

Panama has moved politically from long-term dictatorship to fragile democracy. A May 1984 election was the first in many years (the new President won by a mere 1,700 votes). But whatever government is in place, it is clear that it is politically expedient to encourage the further growth of Panama as a financial center. And Panamanians interviewed during this investigation, unanimously maintained that secrecy was an absolute; that is, not only growth but the very survival of Panamanian banking depends upon maintenance of bank secrecy. Thus, Panama, like the Bahamas and Bermuda, is faced with a Hobson's choice with the Caribbean Basin

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[223] See Commercial Code of Panama, amended, "Gaceta Official," Articles 88 and 89.

[224] Cabinet Decree No. 238 of July 2, 1970.

[225] Law No. 18, January 28, 1959.

[226] Interview with leading Panamanian banker in 1982.

[227] The assets of the offshore banks, e.g., those of the Bahamas, are guaranteed confidentiality as to ownership by a two (or more) step process—secrecy in both jurisdictions with beneficial ownership unknown in both—while at the same time securing safety in the stable Panamanian system.

Initiative. The CBI requires a secrecy haven to enter into an agreement for the exchange of information prior to receiving the benefits of the convention tax deduction aspects of the CBI. Since Panama has a huge, empty convention center (partially funded by the U.S. Agency for International Development) it strongly wants to take advantage of the convention provision. But Panamanians appear to view the costs as too great: "Such a move would devastate the banking system. The flow of funds away from Panama would be like a flood." [228] Hopefully this view, expressed by many, is changing in part as a result of increased government awareness of the problem and in part due to such factors as the 1984 U.S.-Cayman drug agreement.

Panamanian Companies

Registered companies proliferate in Panama. Just how many there are is unknown; neither Panamanian government authorities nor the U.S. State Department were able to ascertain a figure for PSI. In any event, there are thousands of such entities and anyone holding dirty money in Panama usually has a registered company.[229] PSI's own hearings have shown this.[230]

A registered company can be available within hours. One who walks into the right law firm in Panama City will find them already formed and "on the shelf". If needed, an old company can be bought to assist in backdating transactions or for other reasons. One witness testified during a PSI hearing on commodity fraud that his Panamanian attorney took a 5-year-old shelf company and turned it into an "operating company" with a 5-year history of excellent growth. The company came complete with bank recommendations, certified financials and Dun & Bradstreet reports. The witness told the attorney what figures should appear on the most recent year's financial statements. The attorney's "network" did the rest. A registered company in Panama costs less than $1,000 to form and about $250 annually to maintain. A Panamanian company can even be obtained in Europe since some Panamanian law firms maintain offices for the convenience of European clientele. The trade is lucrative; the private bar grosses millions on the sale and management of companies.

Panama has no real mechanism to police, or allow anyone to police, offshore company activities. Present procedures provide that any foreign individual, company or authority which complains or inquires about the activity of a Panamanian offshore company is directed to the Ministry of Commerce. The Ministry examines its files to identify the local agent, usually a Panamanian attorney, and communicates to the foreign correspondent only that information. The foreign victim has only one avenue in which to proceed—he deals as best he can with the agent of notice. Ministry officials agree that they receive many complaints of various frauds perpetrated abroad. No action is taken, however, unless a case is brought in Panama itself.

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[228] Panamanian government officials and bankers interviewed by PSI staff in 1982 and 1983 have voiced this opinion. To a large extent this explains the all-out emphasis on maintaining secrecy. To do otherwise would cause even non-drug money to flee.

[229] There is no record of the number of offshore companies, not even in the hands of the public registrar of companies, who is supposed to know. The minimum figure proposed to us is 100,000; several bank or ministry officials said "millions," including an official in the Commerce Ministry which maintains the registry. Our own calculations, based on the income and reported registration activities of one reputable law firm, suggest that any major law firm can be responsible for thousands of companies.

[230] PSI Hearings, "Commodity Investment Fraud", February 23, 24, 25, 1982. Note: (Ironically, Panamanian citizens frequently move their assets out of the country. One lawyer estimated 50 percent of their holdings are offshore in Europe or the United States.)

Panamanian law does not recognize crimes committed abroad as a basis for any action in Panama. There is no mechanism for disclosure of information if the crime has not been committed in Panama. This is a crucial difference from those countries that will release information if the crime committed abroad would have been a crime had it been committed in the offshore jurisdiction. Thus, the bank secrecy law, together with this element of the criminal law, protects account holders from disclosure or other prosecution. Bank secrecy can be lifted by a court order when a crime or civil dispute actually occurs in Panama. In 1983, banking officials noted that secrecy had been waived in four such recent instances. On the other hand, managers or employees, whether Panamanian or foreign, are subject to fines and imprisonment if they reveal bank information, including that relating to crimes offshore. And piercing this secrecy by conventional means can be found. U.S. Embassy officials acknowledged in 1982 that letters rogatory have been almost totally ineffective in Panama.[231]

There are no requirements of any kind to be met by an applicant for a registered company. Nor do application procedures assure that actual owners of companies are identified. Anonymity is protected not only by secrecy law but by application procedure. Unfortunately, it cannot be seriously argued that Panamanian attorneys should assume the role of guardian to ensure the correct conduct of their companys' principals; there is no such ethical requirement in the United States. Hence, the 3,000 members of the Panamanian bar are content to charter and collect yearly fees and not worry about what the companies are doing. Panamanian attorneys can be expected to powerfully resist any suggestion for change in the present profitable status of Panamanian company law. As one reputable attorney said: "The bar would fight to the death to keep (company registration law) as it is." And, "If the United States were to seek to pressure the government of Panama . . . to change the present system, it would create an uproar. It would threaten our livelihood. . . . We would be vehemently opposed." From yet another source, a highly respected professional we heard this: "Any effort to influence our legislation in regard to Panamanian corporations and banking numbered accounts will not only be futile but will create a tremendous burden for the United States . . . in Panama."

Banks and Dirty Money

As of late 1984, there were 123 banks in Panama, 8 of which are important retail commercial institutions, and 20 of which are in the free zone. At least 55 of the present banks are international banks headquartered abroad, many of them operating in the wholesale Eurocurrency market. Fourteen new banks were formed in

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[231] Furthermore, Panamanian law does not allow foreign authorities simply to take testimony or gather evidence in Panama on their own.

1981, five were formed in 1982, and five more were in the process of being formed. A number of newly chartered banks are Japanese. Bank licensing procedures are now quite strict as a result of several major bank failures over a decade ago.[232] Panama now licenses major international banks already headquartered in responsible foreign countries. It would probably reject applications from banks headquartered elsewhere in the Caribbean, and from subsidiaries of major international banks if those subsidiaries are in the Caribbean. Panamanian officials told PSI they "know what their haven neighbors are like" and, to ensure prudent banking in Panama, they want no part of them.[233] There are no brass plate banks in Panama; therefore, there are no U.S. bank brokers selling Panamanian banks.

Despite Panama's sincere intentions to assure only stable, respectable banking, the bank regulatory authority is denied, by secrecy laws, any right to audit deposits.[234] Therefore, extensive laundering, fraud, looting, and other crimes would tend to surface only after a detailed internal audit by the bank's foreign headquarters or if the fraud actually caused the bank to fail. Panamanian banking authorities are fully aware of these risks,[235] but the resistance of the banking community to any threat to secrecy has made change difficult.

U.S. Currency Repatriation

In early 1983, PSI became aware that the Banco Nacional de Panama had repatriated (i.e., returned) over $1 billion in U.S. currency to the U.S. Federal Reserve Banks in New York and Miami during 1982.[236] Over half the bills were in $50 and lower denominations. Preliminary inquiries revealed that, in 1981, Panama had repatriated $500 million in U.S. currency—up from $250 million in 1980. The currency was picked up on a regular basis by Brink's courier from the Banco Nacional in Panama City and delivered to the Federal Reserve Bank in New York, and later in Miami.

Panama does not have a central bank. The Banco Nacional de Panama, performs the clearing bank function for banks in Panama. It was via this clearing bank function that the huge currency repatriations occurred.

The period 1981 through 1983 saw intense activity by U.S. law enforcement officials who were investigating money laundering. Operation Greenback in Florida was making it very risky to launder currency domestically through Florida banks. Narcotics traffickers therefore turned to Colombian currency exchange houses such as those owned by Beno Ghitis Miller.

Ghitis testified before PSI that his business exploded from moving $2 to $3 million a month in 1978 to $35 million a month in 1981. In the 8 months prior to his arrest, Ghitis had moved ¼ billion dollars. The explosion of Ghitis' business coincided with the arrest of several large Colombian exchange house operators.

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[232] In the 1960's there were 252 banks, most of which had been carelessly licensed. Two stunning failures occurred. In 1969 a reform law was passed, the consequence of which was that all but a few were dissolved.

[233] Interviews with Panamanian government officials conducted by PSI staff.

[234] Ibid.

[235] Another flaw is not one for which Panama can now be held responsible. Before 1969 a registered company could call itself a bank or trust. An estimated 240 identified as banks were dissolved by reform legislation.

[236] Federal Reserve figure.

Ghitis was put out of business in late 1981 and with him went one of the largest Colombian exchange houses. Shortly thereafter stories began circulating among law enforcement officials in Florida about currency backing up on the streets, in cars and in safe houses because of the traffickers' inability to launder it onshore. Hence, it is likely that Panama became an increasingly popular laundering locale and currency began to be moved south. For example, in May 1983, a south Florida accountant was arrested while attempting to fly $5.4 million from Fort Lauderdale to Panama. Records seized after the arrest indicated the defendant had transported $150 million to Panama in the preceding 8 months. Also seized were 64 pounds of cocaine, $40,000 in counterfeit bills, and 16 loaded guns.

Only 3 months later, another group of men were arrested on charges of using a cargo air service for transporting currency from the United States to Panama without filing the appropriate Treasury forms. Evidence was uncovered which indicated that these defendants were replacing the network broken up in May in Fort Lauderdale.

This chain of events, contemporaneous with the increase in currency repatriation to the Fed, indicates that a significant percentage of the currency was drug money. There is no other viable explanation for such a jump in U.S. dollars in Panama (e.g., the U.S. currency is the currency of Panama, gambling is legalized, etc.). Nor were there reasonable explanations as to why Panama was one of the largest repatriators of currency in the world in 1982. Nevertheless, Panamanian officials take very strong exception to this position.

PSI staff embarked on an extensive effort to trace the 1982 currency with the help of senior government accountants. The $1 billion returning to the United States was traced through the Federal Reserve Bank to the Bank of Boston International in New York. At the Bank of Boston International account of the Banco Nacional de Panama, the currency was comingled with all other Banco Nacional transactions through the account. From January through July 1982, $607,393,000 in currency disappeared into $6.2 billion in total deposit transactions representing 143 international banks.

An analysis of deposits and withdrawals to and from the Banco Nacional's account led us to 13 major international banks whose withdrawals through the Banco Nacional's account were tens of millions in excess of deposits each quarter of 1982. As the entire Banco Nacional account is in balance, the currency deposits are withdrawn via some of the 143 banks represented in the account in 1982. Staff analysis indicated that these 13 banks excessive withdrawals could possibly account for the currency coming from Panama.

The analysis continued one step further before reaching an impenetrable wall. Several of the 13 remaining banks were subpoenaed to produce their Banco Nacional's correspondent account to see how feasible it would be to continue the tracing process. The staff quickly discovered that the account transactions again reached into the billions quarterly.

Since major narcotic traffickers can deal in tens of millions in currency monthly, it is not inconceivable that patterns would have surfaced in these accounts. However, the volume and nature of the accounts made it clear that to uncover such patterns would have required massive staff and bank resources with a final definitive result not being guaranteed. Hence, the search was terminated, and the true source of the $1 billion remains a mystery subject only to an educated guess. In any event, the phenomenal growth of the U.S. currency repatrition from Panama is unprecedented. That it could disappear so easily into the billions flowing through the Banco Nacional de Panama's various U.S. correspondent accounts is a testament to the size of the international banking system in Panama and a true indication of how relatively easy it is to hide such large amounts—of whatever origin.

Access to Records in Panama

PSI staff were told there are two methods for obtaining confidential bank and company information from Panama. Yet neither of the routes to obtaining information are effective. The first route is via the foreign authority's embassy to Panamanian foreign affairs officials, thence to the Attorney General who can do nothing if the crime was not committed in Panama. A positive development was indicated, however, in an August 7, 1984 press release by the Department of Justice. The release announced the successful culmination of an international drug investigation called Operation Hammerhead and specifically noted the "personal assistance of Issac Chang Vega, the Attorney General of Panama."

The other, less formal route, is the National Guard (as of October 1983, renamed the Panama Defense Force). Foreign enforcement authorities may utilize this procedure; indeed, in the past there may have been informal directive from the National Guard to rely on it entirely.[237] The Guard has, from time to time shown its good will by providing assistance to foreign authorities. For example, fugitives are occasionally picked up and placed on an outward bound plane. Moreover, the U.S. Coast Guard, when in hot pursuit is readily granted authority by Panamanian authorities to board Panamanian flag vessels suspected of carrying drug cargo. It is formal cooperation of this type which makes some U.S. officials, particularly in the Treasury Department, hopeful of further negotiated gains.

In summary, the United States is important to Panama. There are close historical ties between the countries, but Panamanians do not see U.S. interests as taking precedence over Panamanian ones. Almost certainly Panama will reject sweeping changes to its secrecy practices. Some modest improvements may be attainable, particularly if international opinion can foster a realization that international cooperation and opposition to crime are in Panama's national interest. In the meantime, unless some creative solutions can be implemented, Panama will remain one of the best havens for criminal moneys in the world.

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[237] The directives appear to be contrary to Panamanian procedures by which the Attorney General is authorized to evaluate foreign requests. The informal power of the Guardia Nacional in exercising its prerogatives is evident here. Whatever the official stance, the U.S. embassy and U.S. enforcement agencies appear to be responsible to the informal rules of the National Guard.

The United States faces unhappy alternatives. A particularly bleak one is to acquiesce to the present status of Panama as an iron-clad secrecy jurisdiction. This involves the recognition that, as pressures elsewhere in the Caribbean lead to the exclusion of criminal funds, they will make their way to Panama.

The best alternative now would appear to be to pursue short-term gains via informal agreements along the lines of the United States-Cayman Islands drug agreements. In the meantime, the United States should continue its efforts to investigate and document all cases where a Panamanian connection is suspected in order to thoroughly educate Panamanians who, in good faith, doubt American law enforcement claims.

ST. VINCENT AND THE GRENADINES

St. Vincent and the Grenadines is a group of 17 islands located in the Eastern Caribbean. St. Vincent features a low per capita income, a high unemployment rate (estimates vary from 7% to 35% for a population of 110,000) and is generally considered to be one of the least developed of the LDC's in the Caribbean. The La Soufriere volcano eruption of 1979 and Hurricane Allen in 1980 have strained the already lean budget (GDP $78 million). The banana industry, which has been the country's most important economic activity, made a dramatic recovery after the two natural disasters but began to stagnate in 1981. Tourism, which has never been exceptional due to the lack of white sand beaches and a small airport, also appears to have stagnated. In 1983 the country's balance of payments and public finances were supposed to be deteriorating.[238]

St. Vincent became independent on October 27, 1979, and is now a self-governing State within the British Commonwealth. In order to decrease its trade deficit (imports exceed exports by 500%), the government has adopted several pieces of legislation to attract more offshore financial and trading operations. After the activities of some unscrupulous banks attracted unfavorable publicity, these laws were revised in 1982–1983 in an attempt to establish an acceptable banking reputation.[239]

The International Companies Act, which was passed in 1976 and later amended in 1982, exempts international companies from income tax and from dividend tax on distributions to non-residents. Instead of taxes, international companies only pay the Government a fixed registration fee and fixed annual fees. Banks are defined as "entities which engage or whose purpose it is to engage in the business of banking. 'Business of banking' means any business which includes as an essential feature the acceptance of deposits of money from the public, repayable on demand, for the purpose of lending or investment." Requirements for international banks include obtaining a license from the Governor, paying a fee of EC $10,000 (U.S. $3,700) and every following year EC $5,000 (U.S. $1,850). The character references and financial conditions of the directors are examined as well as the banking experience of the managing director. A major change in the 1982 version is that a security deposit of at least EC $250,000 (U.S. $92,500) must be made with the Treasury Department.[240]

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[238] *"Foreign Economic Trends and Their Economic Implications for the United States-St. Vincent and the Grenadines."* Washington, D.C.: (U.S. Department of Commerce, 1983) p. 3; Staff interviews; Department of State materials.

[239] Interviews with St. Vincent bankers in 1983; *see also* Walter H. Diamond, "Tax Havens of the World: Saint Vincent" New York (Matthew Bender, 1974–1983) pp. 1, 8.

The term "International Companies" as used in the International Companies Act of 1982 embraces international companies, including insurance and shipping companies and banks, and superannuation funds. By law they must not engage in "buying or selling goods in St. Vincent nor in providing services" there, and no resident of St. Vincent may "receive directly or indirectly more than one-tenth of the total value of assets, issued share capital, issued loan capital or interest, dividends or other consideration payable in respect of any loan or preference share." [241] According to the act, "no list of the shareholders has to be submitted to the government of St. Vincent except that the original subscribers of the shares are listed in the Memorandum of Association which must be submitted to the Registrar of Companies." [242] After incorporation the original shareholders may transfer their shares to persons who need never be named.

Section 7 of the act is concerned with disclosure of confidential information:

> 7.(1) Every information that may be obtained by the Governor-General, by the Minister or by the Authority in relation to an International Banking Company shall be treated as confidential and shall not be disclosed except for the purpose of discharge of duties or the exercise of functions under this act or where required to do so by Court or competent jurisdiction or where by any other law of the State the Authority is obliged to divulge the information.
>
> (2) For the purpose of this section "information" includes any information furnished by the applicant in relation to his application and any other information which the Authority may obtain, and "confidential information" shall mean any information concerning the licensee, any customer of the licensee, or any beneficiary of the Trust within the meaning of Saint Vincent Trust Authority Act, 1976, or of any assets, liabilities, transactions, or other information in respect to any customer of the licensee;
>
> Provided that any disclosure made by the Authority or any other Officer after obtaining the permission of Government shall not be deemed to be a disclosure of confidential information in contravention of this section.
>
> (3) Any person who contravenes subsection (1) shall be guilty of an offense and punishable upon conviction with a fine not exceeding $1,000.

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[240] Martin J. Lutz and Peter P. Bertschinger, "Saint Vincent, an Offshore Base and Financial Center," (Kingstown, St. Vincent: Saint Vincent Trust Authority, 1982) pp. 27, 28.

[241] Ibid., p. 13.

[242] Ibid., p. 17.

In 1976, the St. Vincent Trust Authority Act was passed authorizing the formation of international trusts and establishing the St. Vincent Trust Authority, a company controlled by the Government. The purpose of the St. Vincent Trust Authority is to "assist banks, trust companies, auditing firms and lawyers in setting up International Companies and International Trusts through its office in St. Vincent or through its service company which is established in Zurich, Switzerland." [243] The local representatives and resident trustees for the International Companies and Trusts pay to the St. Vincent Trust Authority 20% of the fees charged them. It is felt that by keeping the St. Vincent Trust Authority self-supporting it may carry out its supervisory activity without being dependent on Government contributions. One prominent attorney for several banks on the island, stated that the St. Vincent Trust Authority is 49% owned by Swiss investors.[244] The Authority has the power to accept or refuse applications and make investigations in cases of doubt.

In 1983 the St. Vincent Evidence Act was passed to enable the High Court of St. Vincent to "assist in obtaining evidence required for the purpose of proceedings in other jurisdictions." Although this act is a conciliatory gesture to foreign tribunals, Section 5(l) still protects the offshore investor. This section preserves the privilege of a witness to maintain confidential documents in his possession and other requested information if either the requesting court's jurisdiction or St. Vincent recognizes an applicable privilege. In other words, if St. Vincent recognizes a privilege or the requesting jurisdiction recognizes a privilege then the requested party is not required under the act to yield the requested evidence. Therefore Section 5(1) requires the requesting authority to overcome two hurdles. In order for the evidence to be obtainable it must be admissible under the laws of both jurisdictions.[245] The act also requires resort to the letters rogatory process which allows for disclosure of information pertaining to criminal matters only after the implementation of the criminal proceedings, that U, only in post-indictment situations.

In addition to these acts, St. Vincent does not tax capital gains, has no central bank or currency restrictions on international companies and trusts, and its exchange controls are slack and fairly ineffective. In the past, St. Vincent had 60 double taxation agreements with foreign nations. As of January 1, 1984, the United States has canceled its treaty with St. Vincent.

In August of 1983, two of the subcommittee's staff visited St. Vincent and interviewed bank and government officials and private attorneys. The Director of the St. Vincent Trust Authority has been successful in ridding the island of many unscrupulous banks and has stated that the highest number of banks existing in St. Vincent at one time was slightly over 100. By mid-1979, 76 banks were on its registry; by mid-1983, 46 of those had been canceled by the Authority or by default, and more were to be struck from the registry, by the end of the year. When questioned about local secrecy practices and procedures for obtaining disclosure, the Director said that common law tradition vests much discretion in St. Vincent courts. She assumes the United States would have to establish a solid case in order to obtain disclosure and establish standing before a St. Vincent court which would require the intervention of the St. Vincent Attorney General. The Director feels that revenues produced via licensing fees, are helpful to the economy of St. Vincent, but insisted that the country has gotten much tougher on shell banks and that it will strike a bank's license for cause without hesitation. The Director indicated that St. Vincent would be inclined to cooperate with the U.S. Government as long as it followed St. Vincent laws. That is, if the United States followed proper channels and utilized the Attorney General of St. Vincent, cooperation would be readily forthcoming. On the other hand, she referenced a recent case where an FBI agent had visited and allegedly failed to pay sufficient deference to "local custom." This incident had been viewed with great suspicion by the St. Vincent establishment.

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[243] Ibid., p. 10.

[244] Staff interview in St. Vincent.

[245] See generally, St. Vincent and the Grenadines Evidence Act.

It now appears that the only two operational offshore banks are Owens International Bank, Ltd., and Co-Op Investment Bank, Ltd., both of which pay their fees and are obviously well accepted by the government. Both are shrouded in mystery although Owens apparently has recently attracted the attention of European law enforcement authorities. After PSI investigators exposed the method by which the Co-Op Bank was "capitalized" in its 1983 hearings, numerous inquiries were received from Americans considering doing business with the bank. PSI has also learned of several lawsuits against Co-Op and at least one Federal civil investigation of its dealings. The total number of offshore banks currently recognized by the government is thought to be about 20.

Private sector interpretations of the country's secrecy laws vary. The manager of a large British bank told the staff that an offense must be a crime in St. Vincent for a St. Vincent court to issue disclosure order. Since tax evasion is a crime in St. Vincent, the IRS could conceivably obtain a court order in tax cases involving St. Vincent. However, taxes are imposed only on domestic concerns by the income tax ordinance of 1967 and under the International Companies Act, 1982, international (offshore) companies are exempted from income tax. Indeed, a manager of a domestic bank interviewed remained condident that the police are not able to pierce the secrecy of records except by court order. This view was shared by all the banks interviewed: a Canadian banker insisted that he would disclose account information only upon a court order from the St. Vincent courts.

In any case, unauthorized disclosure is a civil rather than criminal offense in St. Vincent, although one offshore banker insisted it would be a crime to even discuss the type of business his bank was engaged in. On the other hand, a very senior police official told PSI that, with respect to Class B banks, no court order would be required in order to obtain information to pass along to the Justice Department. He said the police had full authority to conduct an investigation upon notice from the United States of an official U.S. investigation. This did not mean the investigation had to reach indictment stage prior to making an inquiry into St. Vincent.[246] This is exactly opposite to what all the bank managers told PSI and to what the letters regulatory procedure indicates.

At any rate, the offshore banking boom in St. Vincent is over. Massive amounts of negative publicity that the country received in the late 1970's has had a noticeable effect.

Consider these cases:

> In *United States* v. *Krown,* Criminal Action No. 80 Cr. 54 (D.C. Cal.) Slip Op., Sept. 5, 1980, Kevin Barry Krown, James Feeny, Anthony P. Cavanaugh, and several other coconspirators were charged with transporting fraudulently made securities in interstate and foreign commerce. Cavanaugh paid Feeny $6,000 for $60,000 worth of fraudulent offshore checks to finance his ventures. The checks were supposedly certified by the First National Bank of Teheran of St. Vincent. He signed a fictitious name as authorized bank signator. Cavanaugh instructed his clients to withdraw over $100,000 created by his deposits. Then he purchased $210,000 from Krown which were drawn on European Credit Bank Corp., St. Vincent, and followed the same procedures, knowing at all times that there were no funds to cover such amounts.
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> In *United States* v. *Crosby,* D.C. Mass, 1982, Peter F. Crosby (brother of James Crosby, chairman of Resorts International) and three others were charged with conspiring to acquire $23.1 million in real estate through worthless cashier's checks issued by Financial Services Bank, Ltd., a St. Vincent bank which was owned and controlled by the defendants; and by issuing financial statements reflecting fictitious transactions with the bank regarding companies controlled by them.

Finally, as noted elsewhere in this Report, WFI Corp. is a Los Angeles company which was incorporated in March 1975 with Jerome Schneider as principal and president. WFI has established banks in tax havens in the Caribbean and the South Pacific for as little as $10,000 and resold them to clients for as much as $37,000. In Schneider's own words, WFI is a "consulting firm which specializes in establishing offshore banks . . . our relationship stops with an offshore bank owner the minute the acquisition process is completed. We are not lawyers, we are not accountants, we are strictly merchants of convenience." During PSI hearings, Chairman Roth introduced a Wall Street Journal article dated March 23, 1981, entitled "Con Men are Raking in Millions by Setting Up Own Caribbean Banks" which stated:

> Mr. Schneider (owner of WFI) used to sell banks on St. Vincent and has even written a book on how to set up and use a bank there. But lately he has been emphasizing Montserrat because of St. Vincent's growing banking notoriety.

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[246] Staff interviews.

The Director of the Saint Vincent Trust Authority told staff investigators that "[in 1979 she] told Jerome Schneider that the banking law in St. Vincent was about to be changed and that he would either have to follow the procedures or go elsewhere. He went elsewhere." [247] Hopefully, the problems posed by St. Vincent banks have subsided. Unfortunately, like WFI, they have merely gone elsewhere.

SINGAPORE

The Republic of Singapore, an island located off the tip of the Malay Peninsula, covers 222 square miles; the city of Singapore covers 37 square miles. In 1965, Singapore was expelled from the Federation of Malaysia, and Prime Minister Lee Kuan Yeu and his anti-communist Government have maintained political stability in the country since that time. The economic growth of Singapore is one of the highest in the world, with an average annual increase of 7.4% from 1960 to 1982. As of 1982, the GNP was U.S. $16.5 billion, per capita income was U.S. $5,500 and the unemployment rate was 2.6%.[248] Like Hong Kong, Singapore is an entrepot city, located at the convergence of sealanes connecting the Pacific with Europe, the Middle East and India. It has become a regional manufacturing base whose three top trading partners are Malaysia, Japan, and the United States. Singapore is considered to be the telecommunications center of Southeast Asia and it has also grown to be the center of the Asian banking world, holding approximately $100 billion worth of Asian currency.[249]

Although a country with a population of only 2,500,000 and virtually no natural resources, Singapore has more than made up for these deficiencies by attracting multinational companies. Its success as an international financial and banking center is due in part to two pieces of tax legislation. Walter Diamond summarizes the content of this legislation as follows:

> First, Singapore does not tax interest on bank deposits earned by nonresidents so that earnings from the Asia currency funds held within Singapore are tax free. Moreover, the banks are granted a reduction to 10% from the normal company profits tax of 40% on interest earned from loans from overseas lenders if the borrowers are offshore corporations or person operating outside of Singapore. The rate also is reduced to 10% on interest, fees or commissions received by Asian Currency Units (financial houses dealing in Asia dollars) for advising, confirming or refinancing offshore letters of credit. Singapore Government tax-free bonds, approved Asia dollar bonds and nonresident deposits with Asian Currency Units held by nonresidents also are exempt from the Estate Duty. The 10% reduced rate also applies to other offshore income from foreign ex-

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[247] *See* Hearings, p. 154; staff interview.

[248] "Handbook of Economic Statistics, 1983," Central Intelligence Agency, p. 24. "World Development Report" 1984, p. 219. "Foreign Economic Trends and Their Implications for the United States, Singapore," U.S. Department of Commerce, 1983, p. 2.

[249] Walter H. Diamond, "Tax Havens of the World: Singapore," Matthew Bender, 1974-1983, New York, p. 17.

> change profits and transactions with domestic banking units and residents. Dividends received in the hands of both resident and nonresident shareholders also are taxed at the 10% reduced rate for Asia Currency Units. . . . Interest paid on Asia currency deposits or on Asia dollar bonds generally is from two to three points higher than the European bank discount rate and offers more profitable return than that earned on investments in many areas of the world. . . .
>
> Second, Singapore follows the original territoriality and remittance systems of taxation of the British Empire and, therefore, offers tax avoidance to nonresident companies and nonresident employees when specific conditions are fulfilled. Nonresident companies in Singapore are exempted from Singapore income and dividend taxes when the Singapore operation has no income arising in Singapore, has conducted no business in Singapore, has no income remitted to Singapore, and is not managed or controlled in Singapore. Thus, Singapore taxes on a territorial basis. However, income earned by Singapore resident companies which has not been taxed in Singapore but has been distributed to shareholders as a dividend is subject to the full normal corporation tax. A company is considered to be a resident of Singapore when its management and control are exercised there. Management and control are normally considered to be exercised at the place where directors' meetings are held.[250]

In addition, there is no capital gains tax or withholding tax on interest earned from foreign deposits. An Income Tax Convention between the United States and Singapore has been proposed but not signed as yet.

From 1970 through March 1981, the number of commercial banks rose from 37 to 100. Eighty-seven of these are foreign owned and serve as a base for regional operations through what is known as the Asian Currency Market (ACU) or Asian Dollar Market. Total liabilities of the banks in the market have risen from U.S. $31 million in 1968 to almost U.S. $65.1 billion in March 1981.[251] The Monetary Authority of Singapore (MAS) performs many central bank functions and administers the system which is regulated by the Banking Act of 1970 and the Exchange Control Act of 1970. The MAS also issues foreign exchange regulations. On June 1, 1978 the foreign exchange regulations were liberalized so that funds could flow more freely between Singapore and the rest of the world. This has resulted in offshore banks dealing freely in foreign exchange and being able to provide credit facilities to residents of Singapore [252] (without extending a qualifying term loan). In terms of world time zones, Singapore is located 7½ hours ahead of Greenwich Mean Time, an advantageous position in that its business hours overlap those of Asian and European financial centers. For example, both Tokyo and London can be contacted by Singapore during regular working hours.[253]

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[250] Ibid., pp. 1, 2 and 3.

[251] Effors, Robert C., "Emerging Financial Centers," International Monetary Fund, 1982, Washington, D.C., pp. 920–927.

[252] "Marketing in Singapore", Overseas Business Reports, U.S. Department of Commmerce, 1981 p. 10.

But perhaps Singapore's greatest advantage is the statutory authority given to bank secrecy in the Banking Act of 1970. Section 42 of the act states:

> 42-(1) Except as provided in sections 40 and 41 of this act, nothing in this act shall authorize the Commissioner to enquire specifically into the affairs of any individual customer of any bank and any incidental information relating to the affairs of such individual customer obtained by him in the course of an inspection or investigation made by him under the provisions of this act shall be secret between him and that bank;
>
> Provided that nothing in this section shall be deemed to limit any powers conferred upon the High Court or a Judge thereof by Part VI of the Evidence Act or to prohibit obedience to an order made under that part . . .
>
> (2) No official of any bank and no person who by reason of his capacity or office has any means access to the records of the bank registers or any correspondence or material with regard to the account of any individual customer of that bank shall give, divulge or reveal any information whatsoever regarding the moneys or other relevant particulars of the account of such customer to—
>
> (a) any person who, or any bank, corporation or body of persons which, is not resident in Singapore; or
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> (b) any foreign government or organization, unless—
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> (i) the customer or his personal representatives gives or give his or their permission so to do;
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> (ii) the customer is declared bankrupt; or
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> (iii) the information is required to assess the credit worthiness of the customer in connection with or relating to a bona fide commercial transaction or a prospective commercial transaction.[254]

Section 43(3) defines a nonresident bank as one in which "the control and management of the business thereof is exercised outside Singapore." [255]

The most well known aspect of the Singapore banking system is the numbered bank account. These accounts are identifiable only by a number or a code word and the names of the owners are known only to a few senior bank officials. These accounts are legal and they are under the jurisdiction of the MAS. The Banking Act of 1970 gives statutory safeguards to ensure the secrecy of numbered accounts. Section 52(1) of the act states:

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[253] Ibid., pp. 10 and 11.

[254] *See* Myint Soe, "The Banking Law of Singapore and Malaysia," Law Book Company of Singapore and Malaysia, 1975, p. 52. Soe states: "It will be noticed that in the above subsection, reference is made to sections 40 and 41. These sections deal with the powers of investigation of the Monetary Authority Singapore (MAS) to investigate into the affairs of a bank in Singapore. In so doing, it is probably contemplated that the affairs of an individual customer might be specifically enquired into, or that incidental information regarding him might come out. The subsection ensures that all investigations made by the MAS shall be kept secret between the MAS and that bank."

[255] Ibid., p. 57.

> 52–(1). The officials of any bank operating numbered accounts on behalf of its customers or any persons who by reason of his capacity or office has by any means access to the records of the bank, registers, correspondence or any other material with regard to numbered accounts shall keep absolute secrecy thereof in the interests of the bank's customers.

According to the act, the only exceptions that can be made to this section would be for the following reasons:

> (a) the owner of the numbered account or his personal representatives gives or give his or their permission so to do;
> (b) the owner is declared bankrupt;
> (c) a suit arises between the bank and the owner relating to a banking transaction; or
> (d) the owner is required so to do by order of a Judge of the Supreme Court made for special cause for the purposes of any civil or criminal proceedings.[256]

Singapore's 1970 Banking Act was amended as of April 22, 1983. The amended version grants even more privacy than the previous one. The new provisions of this act provide that: (1) the MAS may not specifically inquire about an individual's account; (2) when, during an investigation of bank books, the MAS has obtained information about an individual's account, it must be kept secret; (3) when information about an individual's bank account is disclosed in certain civil suits, the court will hear the proceedings *in camera;* and (4) even when a bank employee who has access to the records has ended his professional relationship with the bank, he may not divulge information except in the four situations described in the above paragraph.[257]

Although the Banking Act has been strengthened and numbered bank accounts are legal, as of early 1984 MAS had not given its approval for the actual opening of any such accounts. One view given for the delay in implementing numbered accounts concerns the much publicized case of Achmad Thahir. Thahir, a close aide to the former president-director of Indonesia's State-owned oil company, Pertamina, made deposits in Singapore which totaled $35 million before his death in 1976. When his wife tried to withdraw portions of the money, the oil company argued that the money was acquired illegally through corruption and should be returned to the company. The case has put Singapore in an embarrassing position because it has shown that the country's reputation for bank secrecy is not fool-proof and that Thahir's funds may be seized. On the other hand, Singapore does not want to offend its neighbor, Indonesia, by refusing to cooperate. Additionally, the U.S. Internal Revenue Service has voiced its disapproval of the establishment of even greater bank secrecy in Singapore because of the prospect of attracting tax evaders and drug traffickers from Southeast Asia's Golden Triangle. In any case, Singaporians want public attention from the Thahir case to diminish before anything further is done about numbered bank accounts.[258]

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[256] Ibid., p. 55.

[257] Li Shui-hua, "Singapore: Banking Secrecy To Be Increased," East Asian Executive Reports, January 15, 1983, p. 23.

Singapore and Hong Kong have been rivals for the banking business of Asia for many years, each having certain advantages over the other. The two Asian financial centers have some similarities, such as good communication and transportation facilities, stable political climates, thriving economic conditions, hardworking, efficient, English-speaking work forces and well-developed legal, accounting and insurance sectors. There are several differences which have proved to be advantageous to Singapore: (1) Singapore is in the time zone which permits it to do business with both European and Asian financial centers during normal working hours of the same day; (2) Singapore has not had the withholding tax on interest from nonresident deposits, which until 1982, had sent most deposits from the U.S. and other foreign countries away from Hong Kong to Singapore (This fact alone has contributed greatly to making Singapore the funding center of international loans to Asian borrowers); and, (3) the government of Singapore has taken an active role in both controlling and providing incentives for its development as a financial center and building up its reputation as the center of the Asian international bond market.[259]

A potentially advantageous development for Singapore in its competition with Hong Kong involves the link of the Chicago Mercantile Exchange with the Monetary Exchange of Singapore which was granted approval by CFTC regulators on August 28, 1984. Administrative and transaction costs for banks and companies could be reduced by using the Singapore and Chicago futures exchanges interchangeably. Among the rules that Singapore officials have agreed to impose on traders are regulations on audits and handling of customer funds, on finanical reporting and minimum capital requirements, and investor-secrecy rules will not apply to reporting of market poisitions by large traders on the Singapore exchange.[260] On the other hand, Hong Kong has more headquarters and regional offices of corporations and financial institutions and more trade passes through Hong Kong. Now that Hong Kong has repealed its tax on the interest of foreign deposits, it may attract some of the deposits that in the past have gone to Singapore. But, as noted earlier, Hong Kong's special relationship with China poses potential problems of great magnitude.

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[258] William Branigin, "Singapore May Allow Secret Accounts to Enhance Banking Role," The Washington Post, February 11, 1982, p. A35, and "Observers Barred from Singapore Corruption Case," United Press International, September 19, 1983.

[259] Y. S. Park, "The Economics of Offshore Financial Centers", Columbia Journal of World Business, Winter 1982, pages 32, 33.

[260] Sue Shellenbarger, "Chicago Merc's Planned Link to Singapore Raises Questions on Regulation, Delivery," The Wall Street Journal, February 21, 1984.

THE SOUTH PACIFIC

Micronesia

Micronesia encompasses the island groupings in the Pacific Ocean of the Republic of the Marshalls, the Commonwealth of the Northern Marianas, Palau, and Micronesia, all of which have made up the U.S. Trust Territory since 1947. Recently, each island grouping has formed a separate government, each with its own constitution, locally elected officials, and the authority to enact its own public laws (unless the local laws conflict with U.S. Federal laws applicable to Trust Territories.)

In September 1983, the voters of the Marshall Islands agreed to the Compact of Free Association with the U.S., which will give Marshall Islanders independence except in defense matters. This decision must be ratified by the U.S. Congress and thereafter presented to the United Nations. The actual termination of the Trust Territory might not be imminent because of the political element involved in the United Nation's decision. A plebiscite was held in the Northern Marianas in 1975 to approve a convenant for the island to become a U.S. Commonwealth. The covenant was submitted to the U.S. Congress and enacted in P.L. 94-241.

In 1970, the Congress of Micronesia passed the Foreign Investors Business Permit Act in an effort to stimulate development by encouraging foreign capital investment. In 1974, the U.S. Government terminated all restrictions on foreign investment in the Trust Territory so that any country may now apply for a business permit. Over the years, the island groupings of Micronesia, with their weak economic base, have become dependent on U.S. expenditures and grants. As U.S. Trusteeship of the area draws to an end, the necessity for development of a stronger private sector is obvious. Private sector development has been cultivated and coordinated through the Bureau of Resources, which was created under the authority of the 1970 Investors Act to contact potential foreign investors, monitor their progress, and make reference checks on applicants. Under Title 33 of the Trust Territory Code, foreign investors are required to submit annual reports to the Bureau of Resources.[261]

Marshall Islands

As of June 1979, applications for business permits in the Marshall Islands have been filed with the Secretary for Resources and Development. Permits are issued by the President of the islands. According to the U.S. Department of the Interior, the Marshall Islands have recently issued 25 offshore banking charters. The President of the Marshall Islands, Amata Kabua, wrote to Chairman Roth and stated:

> If it appears that there was a potential in this area of the Pacific for a financial center, you and your subcommittee may be assured that it will be developed within a framework that provides for adequate safeguards, controls

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[261] Trust Territory of the Pacific Islands—Department of State; 32nd Annual Report, 1979, pp. 23-28.

> and monitoring. We will therefore maintain an open line of communications with your subcommittee.[262]

As previously noted in this report, it now appears that the WFI Corporation may be planning to broker banks in the Marshalls.

According to a February 27, 1985 *Wall Street Journal* article, the Marshalls took action in December 1984 to terminate the licenses of 101 offshore banks as of December 31, 1984, due to major scams perpetrated in the United States by several such banks. New licenses will be issued only to these banks which can meet much higher net capitol requirements.

The Northern Marianas

The Northern Marianas is an attractive business location because of its access to U.S. markets as well as its advantageous proximity to the Pacific and Far East markets. It has stable political and defense systems. According to Laurie Neville, a Desk Officer with the United States Department of the Interior, "most Federal laws are applicable in the same manner as in the States. . . . The number of banks and saving and loan institutions have also increased, each governed by U.S. banking regulations." [263]

After the California based WFI Corporation, which sells bank charters, ran into opposition from the government of Montserrat, it moved on to the South Pacific. In an interview with PSI staff, WFI's president stated that he chose the Commonwealth of the Northern Marianas Islands (CNMI) as his principle Pacific location because of its close ties with the United States and because the government of the CNMI responded well to his proposals to encourage offshore "brass plate" banks. In March 1982, Emergency Rules and Regulations for Licensing of Offshore Banking Corporations were issued by the government of the Marianas. According to Mr. Schneider, these rules and regulations were encouraged by him in order to provide adequate supervision of offshore banks. The regulations provided for capitalization of an offshore bank with $10,000 cash, did not require the owners or operators of an offshore bank to have prior banking experience, and provided a certain level of secrecy for the bank's operations and transactions. Moreover, in an "Offshore Bank Offering Memorandum" distributed in 1982 and in a September 16, 1982 "Status Report", WFI claimed that neither the banking nor the securities laws of the United States apply to the Northern Mariana Islands. Circumvention of these regulations is offered by WFI to prospective clients as an advantage to owning an offshore bank in the Northern Marianas. These claims have been adamantly refuted by both United States and CNMI government officials with whom PSI spoke.[264]

Following implementation of the March 1982 Emergency Regulations, WFI obtained 50 offshore bank licenses in the CNMI. Since that time, WFI has sold 38 of the licenses to third parties with pricing ranging from $20,000 to $35,000. On May 12, 1983 the Speaker of the House of Representatives of the CNMI told PSI that the CNMI government issued new Emergency Regulations governing offshore banking which raised the capitalization requirements to $250,000. According to Marianas officials, as of May 12, 1983, none of the 38 WFI brokered banks had renewed their licenses.

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[262] Letter to Senator Roth from Amata Kabua, President of the Marshall Islands, June 17, 1983.

[263] Laurie N. Neville, "Focus on the Pacific Islands" Business America, October 4, 1982, p. 6.

[264] Mr. Daniel MacMeekin, Executive Director of the Northern Marianas Islands Commission on Federal Laws, told PSI staff that, in his opinion, the banking and securities laws of the United States, with few exceptions, do apply to the Northern Mariana Islands.

During PSI hearings, Mr. Schneider, testified concerning his meeting with Commonwealth officials:

> Mr. SCHNEIDER. I had a meeting with the Governor, the Lieutenant Governor, the chief counsel to the Governor and the Director of Finance.
>
> We discussed offshore banking on just one occasion and they felt very receptive toward it.
>
> Chairman ROTH. Again, you discussed secrecy?
>
> Mr. SCHNEIDER. We talked about regulations, yes, sir.
>
> Chairman ROTH. What was the nature of those discussions?
>
> Mr. SCHNEIDER. Well, Marianas is in a strange situation because of many of the laws that are applicable to the United States are applicable to the Northern Marianas Islands. The Government said to me they wanted to offer bank secrecy but they couldn't because of the fact they were judicially in the ninth circuit.
>
> We told them that bank secrecy is just a component of being an international center and we felt we would promote the country as a good banking center without secrecy. They thought that was good and wanted to do that.
>
> We discussed the idea of licensing a number of banks, which we did, and they were amenable to that. They were real concerned about creating what we call tension with the U.S. Government in relation to conducting the——
>
> Chairman ROTH. I am sorry, but I couldn't understand it.
>
> Mr. SCHNEIDER. They didn't want to create any tension, friction between the U.S. Government and the Northern Marianas Government. But, on the other hand, it is a poor country and they need money.[265]

Mr. Schneider promoted the Northern Marianas as a tax haven with secrecy in one of his sales brochures dated August 1, 1982. He spoke about this at the Senate hearing:

> Mr. SCHNEIDER. There are secrecy laws as part of rules and regulations that say they permit and authorize the confidentiality of the records between the clients and bank and client and government.
>
> Mr. WEILAND. Mr. Schneider, there is a statement in one of your circulars dated August 1, 1982, in which you are promoting the Marianas as a jurisdiction to locate an offshore bank. . . . A particular quote has struck our attention. It says "No information provided in compliance with these regulations shall be furnished to any third party."

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[265] Hearings, pp. 196–197.

> Do you remember inserting that statement in your circular?
>
> Mr. SCHNEIDER. Yes.
>
> Mr. WEILAND. The actual regulation, upon our examination, goes on to say, "Except upon court order, subpoena or other judicial process or the expressed consent of the parties involved". . .
>
> Mr. SCHNEIDER. Just to emphasize the point. When asked about it specifically, we explained the whole thing in context. It is part of the marketing process.
>
> Mr. WEILAND. Part of your marketing process to attract clients by representing there is bank secrecy in these various jurisdictions; isn't that true?
>
> Mr. SCHNEIDER. We have represented there is bank secrecy in various jurisdictions. . . .[266]

Governor Tenorio signed into law a new banking code in February 1984 which will impose rigid controls on the establishment of offshore banks. Before an offshore bank may be licensed, it must now meet the following conditions: (1) it must pay a $5,000 initial fee and $5,000 each following year for up to 5 years; (2) names and addresses of stockholders owning more than 5% of the stock must be provided; (3) an investigation must be made of the financial and criminal backgrounds of each major stockholder (5% or more); (4) administrators must take a diligence oath; (5) the Director of Commerce and Labor must be notified of any transfer of more than 10%. Penalties for violations of this code may be as much as $50,000 in fines or up to 1 year of imprisonment.[267]

Other Islands

Nauru and Vanuatu are islands in the South Pacific, with the closest major land mass to them being Australia. They are both recently independent and are trying to develop their financial sectors by encouraging offshore banking, as they have very few natural resources to develop and are running out of the ones they have. Time zone factors could act as an advantage for doing business with banks in Asia, and their remoteness could prove to be an advantage over the Caribbean which has received recent publicity and scrutiny.

Vanuatu

The island nation of Vanuatu, formerly New Hebrides, was the only colonial possession jointly ruled by France and Great Britain. Three pieces of liberal British financial legislation—The New Hebrides Companies Regulation of 1971, the New Hebrides Trust Companies Regulation of 1971, and the New Hebrides Bank Regulation 1980—established New Hebrides as a tax haven. During the early 1970's the capital city, Vila, boomed, the expatriate population multiplied, and an international atmosphere flourished in this tax free environment. Thirteen offshore banks were quickly established. There now exist about 500 exempted companies and 37 exempted banks.[268] For Hong Kong investors who wished to avoid the Hong Kong 15% interest tax, New Hebrides became an important loan booking center. In addition to offering complete tax exemption, some international companies used New Hebrides as their Pacific base because it was farther away from mainland China.

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[266] Ibid., pp. 197-199. Also see hearing exhibit 21, pp. 199.

[267] "Banking Code may half offshore banking Business," Marianas Variety News & Views, February 10, 1984, p. 1.

In July 1980, New Hebrides became independent and its name was changed to Vanuatu. The British had pushed for independence; the French opposed it. Shortly before Vanuatu gained independence, separatist leader Jimmy Stevens led 800 islanders armed with bows and arrows and 50 French-speaking Europeans armed with shotguns from the island of Espiritu Santo, in a rebellion against becoming part of the new independent nation. Troops from Papau, New Guinea were called in to put down the revolt and its leader was jailed. Thus, the atmosphere of political stability, which is essential to a tax haven, has deteriorated and many investors are now waiting to see what develops in Vanuatu, even though the extremely favorable banking and tax laws still exist.

Under the Companies Regulation Act of 1971, as amended, an exempted company may be formed if it is engaged only in offshore business, holds an annual meeting of the board of directors in Vanuatu, and files an annual return. Strict secrecy is enforced with regard to the company's affairs; in a legal dispute it may have its affairs discussed only *in camera*.[269] Penalties for breach of secrecy are set forth in the Companies Law of 1971, Article 416 and can be $1,000, or imprisonment up to 12 months, or both. The legal basis of bank and company secrecy is found at Article 416-3 of the Companies Law:

> With the exception of the exercise of its functions, within the framework of the present regulations, or of a legal requisition by a competent court of the New Hebrides, for the application of the present law or any other law applicable to Her Majesty's subjects in the New Hebrides, or for the examination of government accounts, no person will have to give to any other person or entity any information whatsoever . . . during his employment or after such employment has come to an end.[270]

An exempt company that has received a banker's license for offshore activity is considered an exempt bank. There are no international agreements relating to double taxation, and there is no exchange control. Vanuatu banks fall into two categories: A or prime banks, and B or those not allowed to participate in local business, but otherwise having fewer restrictions.[271]

Vanuatu does have a Central Bank which may inspect the books and accounts of financial institutions, although it does not entitle the inspectors to examine any information about the affairs of the institutions' customers.[272] Vanuatu has likewise been targeted by the bankbroker, WFI Corporation, as a "Switzerland of the Pacific".

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[268] *See generally*, R.A.S. Forster, "Vanuatu: The End of An Episode of Schizophrenic Colonialism," Round Table, October 1980, p. 371; Caroline Doggart, "Tax Havens & Their Uses," EIU Special Report No. 105, March 1983, p. 128; Edouard Chambost, "Bank Accounts: A World Guide to Confidentiality," trans. Peter Walton and Margaret Thompson (Chichester: John Wiley & Sons, 1983) p. 221.

[269] Ibid., Doggart, pp. 129-130.

[270] Walter Diamond, "Tax Havens of the World: Vanuatu," New York 1983, p. 12.

[271] Ibid., p. 9.

Nauru

The eight and one-half square mile island of Nauru is the smallest and richest independent democracy in the world. The entire central plateau of this island is covered with phosphate which is mined to be used as fertilizer and exported to Australia, New Zealand, and Japan. Nauru has been jointly administered by Australia, New Zealand, and Britain after World War II until its 1968 independence when it became an associate member of the British Commonwealth of Nations. At that time, the profits from the Nauru Phosphate Corporation were turned over to Nauruans and their government. But while phosphate mining has provided Nauru a great source of wealth, it is estimated that by the 1990's the supply of phosphate will be depleted. The island has no other exports; the scarred land is unsuitable for farming and makes an unappealing area for tourists or retirees. Presently, the sale of phosphate brings the government almost $123 million annually (more than $27,000 a year for each man, woman and child), although most of the money is in various public trust funds and investments which are intended to take care of the people when the phosphate runs out. There is some criticism that the investments have not been made wisely. Concerning possible financial alternatives, Finance Minister Aroi has said "we are dabbling with the idea of a tax haven." [273]

Nauru is politically stable and is located far enough away from militarily entangled areas to present an image of security. The financial incentives for investors include the absence of any income, corporation, capital gains, real estate, inheritance, estate, gift, sales or stamp taxes and duties. Offshore companies are required to pay an annual fee of $220 for registration and the screening process is relatively lax. The Bank of Nauru was established as the Central Bank in 1976 and is empowered to approve offshore banking licenses.

Nauru also provides transactional and financial confidentiality for investors who choose to operate through corporations or trusts. In order to obtain confidentiality, investors must incorporate under the Nauru Corporation Act of 1972, as amended in 1973, as a holding corporation, as opposed to a trading corporation. Under the act, prospectuses are required to be filed with the registrar only in the case of the public offering of shares or debentures, which is not allowed by a holding corporation. Any document which is required to be filed with the registrar by holding corporations; such as an annual return, is not available for inspection other than by insiders of the corporation. Additional information required to be maintained by the holding corporation, such as minutes of meetings and registers of holders of debentures and accounts respecting corporate transactions, may be kept solely at the registered office of the corporation.

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[272] Republic of Vanuatu, The Central Bank of Vanuatu, Act No. 3 of 1980, Part 7, Section 33, p. 17.

[273] Paul A. Gigot, "The Smallest Nation Has a Rare Problem: Too Much Wealth." The Wall Street Journal, September 22, 1983, and Robert Trumbell, "Wold's Richest Little Isle," The New York Times Magazine, March 7, 1983.

An investor wishing to operate in trust form is afforded confidentiality through the Nauru Trust Corporation Act of 1972. That act establishes the Nauru Trustee Corporation, a government entity, which is commissioned with authority to act as trustee. The Nauru Trust Corporation has the duty under its charter and other provisions of the act, to maintain as confidential the names of the settlor(s) of the trust, the beneficiaries of the trust, and the accounts of all its transactions. This act provides:

> The Corporation and the officers, servants and auditor thereof, and every person appointed under subsection (2) of section 15 to examine any trust account, trust transaction, investment or trust security of the Corporation shall not, without leave of the resident magistrate, make any disclosure of the identity of the creator of any particular trust or of the identity of any beneficiary under any particular trust otherwise than is necessary for the purposes of administering such trust or investing or recovering or getting into the assets thereof or as authorized by this act.[274]

In addition, Section 10 of the Nauru Foreign Trusts, Estates, and Wills Act of 1972 shields a foreign trust from the imposition of taxes.

The Republic of Nauru Finance Corporation Act of 1972 allows official agencies of the Government to "borrow and lend funds in the interest of developing the Republic of Nauru as a financing community." [275] In his discussion of Nauruan attitude toward insurance companies, Diamond notes:

> As an integral part of the Insurance Act of 1974, as amended, insurance companies are given a relatively free hand in the Republic. Because there are no restrictions on the organization of insurance companies, Nauru is an ideal location for establishment of a foreign-base insurance company or an offshore mutual insurance company for businesses wishing to insure risks in Central and South Pacific. Licenses are granted for offshore operations. The license fee is a fixed annual charge.
>
> In the past, less than a half dozen United States and Australian companies have used Nauru as a base for their offshore "captive" insurance operation. However, the Republic has made it known it would welcome multinational operations wishing to cover certain insurance risks in the Pacific area.[276]

Apparently, the WFI Corporation likewise hopes to be welcomed as it has included Nauru as one of the "Switzerlands of the Pacific."

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[274] Nauru Trustee Corporation Act, 1972, § 35.

[275] Ibid., at 273, p. 5.

[276] Diamond "Nauru", pp. 5–6.

SWITZERLAND

Switzerland is extremely important to the Eurocurrency market. With less than 0.03 percent of the world's population, it is the third largest financial power. It is the world's leading market for gold and re-insurance. At the end of 1977, identified foreign deposits on hand in Switzerland were about $50 billion.[277]

Whether Switzerland is a laundry or investment depository for criminal funds is a matter of debate. There is no doubt that it is a sanctuary for flight capital in violation of other nations' currency laws and it is certainly an important depository for moneys enjoying tax minimization. Nevertheless, as with all major Euromarket centers, the primary sources of deposits are derived from industrial and interbank activities.

The Swiss, like the British, consider themselves a finanical center rather than a tax haven. Fully 3 percent of the work force is in banking. Certainly Switzerland's haven characteristics are limited. Switzerland does not charter offshore Swiss companies. Swiss registered companies pay taxes on income and must have local directors. There are current proposals to tax fiduciary (trust) accounts administered in Switzerland at a rate of 5 percent. Furthermore, Switzerland levies the highest withholding tax on dividends and interest of any nation—a flat rate of 35 percent on all revenues on shares and bonds issued by Swiss companies and on fiduciary deposits made in Switzerland. Swiss licensing procedures are strict, and the country's chartered banks operating abroad do so under the controls of Swiss federal authorities, the National Bank and the Banking Commission. On the other hand, in 1980 there were 4,887 banks (including branches serving 3,000 towns), trusts, and other "financial institutions" in Switzerland; some 557 of these could be considered headquarters institutions.

The professional secrecy of the Swiss banker is rooted, in part, in Articles 27 and 28 of the Swiss Civil Code which grant to individuals protection for their secrets independent of any contractual relationship. The first paragraph of Article 28 stipulates: "Anyone who comes under an illicit attack on their interests can ask the court to take action."

A legal basis of the Swiss banker's duty of confidentiality finds a complementary source in the general clauses of the *Code des obligations* and, in particular, Article 398 of that Code. According to Article 398, "The authorized agent [the banker] is responsible toward the authorizing person [the depositor] for the good and faithful performance of his contract." [278]

Since 1933, Article 48 of the Swiss Bankers Code has provided bank secrecy with a criminal sanction. But this is counterbalanced by Switzerland's Treaty of Mutual Assistance in Criminal Matters [279] with the United States which routinely allows bank secre-

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[277] P. deWek, "LaSuisse et les Capitaus etrangers." Paper presented at the General Assembly of Swiss Banks and Holding Companies, Zurich, November 2, 1979.

[278] Edouard Chambost, "Bank Accounts, A World Guide to Confidentiality," John Wiley and Sons, 1983, New York, p. 243.

[279] Treaty Between the U.S. and the Swiss Confederation on Mutual Assistance in Criminal Matters, done May 25, 1973 (entered into force January 23, 1977). 27 U.S.T. 2019 (see doc. No. 15). By 1982 there had been 131 U.S. and 41 Swiss requests for judicial assistance, and 6 U.S.

Continued

cy to be lifted upon a limited showing by U.S. authorities. According to informed Justice Department statistics as of early 1984, some 250 requests have been made under this agreement, 248 of which have been granted by the Swiss. A new Swiss law (International Mutual Assistance in Criminal Matters, "IMAC") came into effect January 1, 1983. It will extend to all nations the same information provision and investigation rights as exist under the U.S.-Swiss Treaty. Under the law, foreign prosecutors will have the same powers in Switzerland as do Swiss prosecutors who will work on their behalf. IMAC also contains a broadened application to tax affairs, although tax "evasion" as defined in the U.S. is not a criminal matter in Switzerland and, consequently, tax cases which do not involve "fraud," at least as the Swiss define the term, do not fall under provision-of-information procedures. IMAC assistance will be available for tax fraud without respect to any organized criminal involvement.

Switzerland has been active in furthering the extension of national and headquarter supervision of overseas bank branch activities under the auspices of the Bank of International Settlements located in Basel. Switzerland also enjoys an important and unusual Convention on Diligence—revised July 1982, effective November 1982—which is supervised by the Commission Arbitrale, an executive arm of the National Bank. The Convention requires that bankers be held responsible for the proper identification of all new depositors, including those creating fiduciary accounts, and for assuring that funds are not criminal in origin.

Under Article 3 of the Swiss banking code, it is unlawful for a Swiss banker anywhere to do business knowingly with anyone but persons of good character. The sanction also applies to Swiss working abroad. By this device Swiss authorities strive to maintain, via federal bank supervision of overseas branches, the honest use of Swiss banks.

There is a large loophole in the Convention on Diligence of which Federal banking and prosecutorial authorities are aware, and which they are seeking to alter. An attorney or certified auditor (CPA equivalent) of a professional notary may represent to a bank that his client is known to him and that the funds being deposited by the professional who enjoys privilege under the law, as nominee, are not of criminal origin. The codes of conduct for attorneys differ from canton to canton, a matter which presents problems to federal authorities in enforcing diligence. But federal police authorities, themselves notably strict and competent, have expressed the opinion that current Swiss law has in fact made Switzerland an unfavorable repository for criminal moneys.[280]

The Memorandum of Understanding (MOU) between the U.S. (by the Securities and Exchange Commission) and Switzerland on insider trading is another significant development.[281] The MOU con-

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and 2 Swiss extradition requests. Most requests under the treaty have been for bank or business information relevant to charges of white collar crime. In 80 percent of the cases convictions or guilty pleas have been forthcoming after Swiss records secrecy was lifted; in Switzerland convictions were obtained in 90 percent of the cases. An outstanding case is that of Frank Sindona in which Zurich and Geneva bank records proved critical to prosecute him for his role in the Franklin Bank collapse. The 25-year sentence Sindona received was considered very severe.

[280] PSI staff interviews.

[281] International Legal Materials, V. 22, N.1, (Jan. 1983) p. 1.

tains a provision wherein the Swiss Banker's Association unilaterally agreed to field SEC inquiries through a "Commission of Inquiry". The Commission, in turn, can promptly demand reports from the member banks. Ultimately, the Commission is supposed to furnish the Swiss Federal Office of Police Matters with its own report to be forwarded to the SEC, unless no insider trading by the SEC's target is found. The Commission can also order member banks to block customer accounts pending resolution of the matter in the United States.

In early 1984, the Swiss enacted a law on insider trading. By criminalizing such trading Swiss secrecy can be breeched through the use of the 1977 Treaty, thus avoiding the necessity of resorting to the Swiss Banker's Association "Commission of Inquiry".

John M. Fedders, of the Securities and Exchange Commission, testified before the Permanent Subcommittee on Investigations about the problems associated with securities enforcement and insider trading. He noted:

> Foreign participation in the U.S. securities markets has increased dramatically. . . . In 1982, stock and bond transactions in our capital markets by foreign financial institutions exceeded $53 billion.
>
> Enforcement of the U.S. securities laws is often frustrated by foreign secrecy and blocking statutes.
>
> An example is *SEC* v. *Certain Unknown Purchasers of the Common Stock of, and Call Options for the Common Stock of, Santa Fe International Corporation,* (the "Santa Fe case"), which involved purchases of common stock and call options for the common stock of the Santa Fe International Corporation immediately prior to the public announcement of a merger between Santa Fe and the Kuwait Petroleum Corporation. Various banks purchased the securities for their own omnibus accounts and refused to divulge the names of the principals for whom they engaged in the transactions.
>
> In the *Santa Fe* case, the Commission has been seeking the identities of the unknown purchasers since October 26, 1981, when the case was filed. After lengthy discussions with the defendants' counsel and the government of Switzerland, a decision was made to apply for assistance pursuant to the 1977 U.S.-Swiss Treaty on Mutual Assistance in Criminal Matters. That request was made in March 1982. In January 1983, the Swiss Federal Tribunal denied the requested assistance. Since that time the Commission has sought other avenues, short of compulsory measures, to learn the customers' identities. To date, efforts have failed. As a result, the litigation has been stalled while an inordinate amount of resources has been consumed.[282]

On May 16, 1984, a Swiss Court ordered three Swiss banks to hand over records to the SEC. While this is certainly good precedent, it may be a Pyrrhic victory: The amount of litigation required was staggering and, in no uncertain terms the Swiss electorate indicated its desire to preserve the secrecy tradition. (In a May 20, 1984 vote, over 70% rejected an initiative by Swiss Socialists to change the law).

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[282] Hearings, p. 318 et seq.

In any event, it is hoped that the concept of the United States Mutual Assistance Treaty will result in a whole network of other such treaties.[283] In the meantime, there is some hope for expanded bankers' diligence rules. For example, during the course of the staff's study, the Bahamian Bankers Association undertook to apply standards much like the Swiss.[284]

TURKS AND CAICOS ISLANDS

The Turks and Caicos Islands is a British Crown Colony located at the southern end of the Bahamas chain, 90 miles north of Haiti, 600 miles from Miami. The population of 8,000 live on only 8 of the more than 40 islands. The government, business, and financial centers are all located on Grand Turk. The main exports are frozen crawfish and dried conch meat, the chief crops are maize and beans, and about 10,000 tourists visit the islands each year. One of the government's top priorities is the development of tourism and at least one large hotel chain has built a large complex in the islands. There is a large trade deficit and the colony is dependent on the $2 million grant-in-aid received annually from the United Kingdom, which is included in the $10 million total budget. Because of this financial dependence, there is no movement toward independence and the islands are considered politically stable.[285]

There are no income, capital gains, corporate, sales, real property, personal property, withholding, payroll, inheritance, gift or estate taxes. Government revenues are restricted essentially to import duties and licensing fees although government sources told PSI that 8% of revenues come from company and bank licensing. Over the past few years the government has passed legislation with the intent of encouraging offshore banking in order to raise badly needed revenues. In addition to the legislation, further incentives include these factors: the U.S. dollar has been the official currency since 1973, there are no exchange controls, and bank accounts may be kept in any currency. Because there are no income taxes, the islands do not have any tax treaties to avoid double taxation, and therefore, there is no exchange of tax information with any other government. In late 1984, there were two flights per week between Miami and the Turks and Caicos Islands and telephone, telex and cable facilities are considered adequate.

A new, comprehensive Companies Ordinance was enacted in 1981. Under this act, an exempted company enjoys favorable provisions such as: (1) it need not file annual information return with the Government, other than a declaration that the company is in compliance with the Companies Ordinance and conducts its business mainly outside the islands; (2) it need not report or disclose its shareholders, directors, or officers to the Government; (3) it need not maintain at its registered office a register of shareholders, directors, and secretaries, nor of mortgages and charges; (4) it need not hold an annual meeting and need never hold a meeting in the islands; (5) its subscribers, shareholders, directors and officers need never set foot in the islands; (6) it need not have local shareholder participation; (7) it has no minimum capital requirements; (8) it may obtain a 20-year guarantee from the Government against possible future taxes; (9) it may obtain a 20-year guarantee from the Governor against possible future increases in annual company fees charged by the Government; and, (10) it may issue bearer shares. (Payment of an initial fee of $500 and annual fee of $150 thereafter is required.)[286]

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[283] The United States has negotiated or is working on mutual assistance treaties in criminal matters with Turkey, the Netherlands, Italy, France and Germany. The Colombian treaty, now in final form and awaiting ratification, allows for assistance in one country for violation of laws in another which are not acts criminal in both.

[284] See section on Bankers Diligence for a complete discussion.

[285] Walter H. Diamond, "Tax Havens of the World: Turks and Caicos," Volume 3, Matthew Bender, 1974-84, New York, pp. 4, 5.

A company can be incorporated quickly and easily in the Turks and Caicos, usually within a week, or under urgent conditions, within a few hours. Before a certificate of incorporation is issued, a Memorandum of Association and Articles of Association must be filed with the Registrar of Companies and an appropriate filing fee must be paid. It is possible for a beneficial owner to incorporate without ever going to the islands. Qualifying shares can be subscribed for and held in the islands by a local representative who may then turn the company over to the offshore principals after incorporation. Capital in any currency may be used to form a company.[287] Given this environment private companies are flourishing in the Turks.

The 1979 Banking Ordinance provides for two types of financial institutions: Class A banks, which offer local checking accounts, and Class B banks which operate in the Turks and Caicos as offshore entities and refrain from offering local checking accounts. For the "B" license, a minimum paid-in-capital of $125,000 and an annual license fee of $5,000 are required. Offshore banks are required to file annual audited financial statements, but no information is disclosed concerning individual customer's accounts. Recently, the number of banking licenses issued in the Turks stood at 12. The leading banks include the Bank of Nova Scotia and Barclays. There is no central bank. Government officials in the Turks hope that eventually 20 to 30% of their budget will come from licensing of banks and companies.[288]

Because of the absence of statutory regulation and control in the area of trusts, great leeway exists for the design of trusts and trustee powers and duties. Companies may be designated as trusts with no minimum paid-in-capital, the same government maintenance fee as for an exempt company must be paid, and no disclosure of financial statements is necessary. Government sources told PSI that these common law trusts have presented problems and are considered anathema by the Government. Such trusts can produce enormous scams and the Government is working on a trust companies ordinance which might make it an offense for U.S. lawyers to write a trust in that jurisdiction. The law would provide that any Turks trust must be executed solely in the Turks.[289]

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[286] Barry Spitz, "Tax Havens Encyclopedia: Turks and Caicos," London Butterworths, 1975-84, London, pp. 5.

[287] Ibid., pp. 5, 6.

[288] PSI interview in Grand Turk, September, 1983.

The Turks and Caicos has a Confidential Relationships Ordinance which was enacted in 1979 and states in part:

> Any person who: (a) being in possession of confidential information, however obtained, (i) divulges it to any person not entitled to possession thereof; or (ii) attempts, offers or threatens to divulge it . . . (b) obtains or attempts to obtain confidential information to which he is not entitled (in the normal course of business), shall be guilty of an offense.

The ordinance further provides penalties for disclosure which are among the most encompassing and harshest of all tax havens:

> Any person who commits an offense under this section shall be liable on summary conviction:
>
> (a) in the case of an individual to a fine of $5,000 or to imprisonment for 2 years or to both such fine and imprisonment; or
>
> (b) in the case of a body corporate to a fine of $25,000;
>
> Provided that where an offense under this section is committed by a professional person, that person shall be liable on conviction;
>
> > (i) in the case of an individual to a fine of $10,000 or to imprisonment for 3 years or to both such fine and imprisonment; or
> >
> > (ii) in the case of a body corporate to a fine of $50,000.[290]

PSI staff visited the Turks and Caicos Islands in 1983 to interview government officials and managers of the leading banks concerning offshore banking problems. At that time they were told that there are approximately 4,100 companies on the books in the Turks with only a few of those believed to be exempt offshore companies. Less than 100 U.S. companies are thought to maintain bank accounts in the Turks. The Turks achieved the goal of 5,000 companies to be registered by the end of 1983.

Officials have stated publicly that if a crime is committed offshore which is also a crime in the Turks, the Government will provide full cooperation if U.S. law enforcement provides sufficient background statements to the Turks and Caicos' Attorney General. Tax matters are not covered by the double criminality rule because there are no taxes in the Turks. Hence, as in so many other jurisdictions, information solely for the use of tax investigations cannot be obtained from the Turks.[291]

In the past several years, the Turks and Caicos have been involved in several well publicized scams and U.S. legal cases. During subcommittee hearings on Crime and Secrecy, Thomas Stocks, former President of the Oxford International Bank and Trust Co.,

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[289] Ibid.

[290] Ordinance to Give Sanction to the Duty of Non-Divulgence of Information, Nov. 3, 1979. "Transnational Litigation: Practical Approaches to Conflicts and Accommodations." Volume II, Documents 38–117, American Bar Association National Institute, pp. 1390–1392.

[291] PSI interview in Grand Turk, September 1983.

Ltd., of the Turks and Caicos Islands, testified concerning two of these schemes which may be summarized as follows:

- The Oxford Bank unwittingly became involved in two questionable business deals, the latter of which ultimately resulted in the failure of the bank. The first incident involved a man named George Edder and a $5.5 million certificate of withdrawal.

  The certificate was purported to the bank to represent 10 million pounds of copper and was delivered to the Oxford Bank for safekeeping. Mr. Edder appeared at the bank one day claiming ownership and demanding return of the certificate. Since the certificate was delivered to the bank by someone other than Mr. Edder, his request was refused. He protested strongly to officials of the Turks and Caicos Government and damaged the reputation of the bank. Mr. Edder proceeded to file a $5.5 million lawsuit against the Bank in California. The suit was eventually settled out of court but not without substantial expense to the bank, both monetarily and in reputation.

- Stocks also described an incident wherein the bank was victimized as part of a stolen securities scam. According to Stocks, he was approached by one Fred Yeager who claimed to represent security dealers in Spain. Yeager opened an account at the bank and apparently had also applied to the Turks and Caicos government for three bank licenses. Yeager asked that the bank serve as an intermediary in the sale of these securities in order to keep the proceeds offshore and to insulate his Spanish clients from taxes. Stocks opened an account in the name of Oxford Bank at Merrill Lynch in New York.

  In November 1978, Stocks agreed to meet Yeager in Haiti to receive $75,000 worth of New York City Battery Park bonds. Since the bonds looked authentic, Stocks proceeded to negotiate them through Merrill Lynch. Payment was made in Florida and Stocks carried the currency back to the Oxford Bank where he paid off Yeager.

  Stocks testified that approximately 2 weeks later he received $500,000 worth of bonds and later $700,000 and $2 million worth of bonds from Yeager. He testified that in the first two instances he delivered the bonds to Merrill Lynch in Miami, received a check which he cashed at Oxford's correspondent bank and carried the currency back to the Turks.

  Ultimately, Merrill Lynch realized the Battery Park bonds were stolen and Stocks was met by FBI agents in Miami. Although neither Stocks nor the bank were criminally liable, Merrill Lynch succeeded in freezing Oxford's correspondent account in Miami. This caused liquidity problems for the bank which ultimately lead the Turks and Caicos government to revoke its license in April 1979.[292]

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[292] Hearings, pp. 93–95.

Another situation implicating the Oxford Bank involved Lowell Anderson, a U.S. tax protestor, who referred U.S. customers to the bank. Most of these customers established accounts in the names of trusts. He often set up these trusts for people through local island residents, such as cab drivers. PSI Chief Investigator Charles Morley described some of the staff's findings at a PSI hearing on offshore banking:

> Mr. Anderson, Lowell Anderson, was indicted 2 to 3 weeks ago in Wyoming on charges arising from his activities as a tax protest leader. It is our information that Mr. Anderson is a self-professed tax protest leader and a member of the posse comitatus and at one time was a member of the Patriots, both tax protest groups in the United States. Our investigation further showed that there were certain relationships between these individuals and Mr. Anderson, which is to say they made payments to Mr. Anderson or received payments back from Mr. Anderson.[293]

Staff investigator Tom McLaughlin, detailed to PSI by the Secret Service went on to point out that a mere handful of U.S. citizens deposited over $1 million to accounts at the Oxford Bank in a 6-month period.[294]

Other instances of utilization of Turks and Caicos facilities exist:

> In 1977 the Zmudas of Olympia, Washington, flew to the Turks and Caicos to establish a foreign business trust with the aid of two strangers. The trust deeds were given for U.S. property on which they held mortgages and payments were made in the name of the trust and deposited in several U.S. bank accounts.
>
> The IRS claimed that the trust was a sham, its only function was to collect payments and the Zmudas remained owners of the property and were liable for taxes.
>
> The Court agreed with the IRS and stated that a taxpayer may minimize taxes in any legal manner, but it does not include "The right to structure a paper entity to avoid tax when that entity does not stand on the solid foundation of economic reality." [295]

PSI's March 1984 hearings on "Commodity Investment Fraud II" disclosed that the owners of Universal Precious Metals, David Bentley and Jack Rose are thought to have made significant transfers of real estate holdings to offshore corporations formed in the Turks and Caicos (Bentley $900,000, Rose $440,000).[296] Senator Rudman stated:

> It is safe to say that normally such transfers would not raise questions, but PSI has learned enough of the illegal use of offshore corporations in previous hearings to suspect

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[293] Ibid., p. 99.

[294] Ibid., p. 103.

[295] *George V. Zmuda and Walburga Zmuda* v. *Commission of IRS*, Docket No. 8572-80, 79 T.C. 714 (Nov. 8, 1982).

[296] See also Dan Lovely and Buddy Nevins, "Lawyers golden ties under investigation," Fort Lauderdale News, January 30, 1984.

> that these are not "normal" property transfers. In the first place, the attorney for Bentley and Rose, one David McKenzie is the U.S. representative for both these offshore corporations. Secondly, both corporations were set up on the same day that the properties were transferred. In addition, the property transfers included the personal residences of both Bentley and Rose, and both Bentley and Rose continued to reside in these allegedly transferred properties. Finally, we have found that both these corporations are identical in virtually all respects except for having distinct names. . .
>
> Our experience with the questionable if not illegal use of offshore corporations leads us to believe that this is a typical ploy by Bentley and Rose to, what is euphemistically called, "shelter" their assets from United States authorities. Both can now claim that they no longer own the assets and only "rent" them from a Turks and Caicos company of which they will no doubt say they know nothing. I think it is fair to assume that if one could go behind these transactions, one would find that in fact Bentley and Rose have total control over both offshore corporations through their so-called representatives in the Turks and Caicos.[297]

Government officials of the Turks and Caicos are aware of the numerous problems which arise in new tax havens. These officials have told subcommittee staff that they are determined that the Turks and Caicos will avoid a reputation for receipt of dirty money. However, they are also anxious to ensure that appropriate secrecy policies and laws are maintained for they are convinced that secrecy is necessary to build even a small financial center.[298]

Bankers and attorneys on Grand Turk likewise expressed concern for maintaining secrecy while preventing criminal use of the country's facilities. Banking officials stated that they require references from United States depositors and Barclays Bank would even require a letter from an attorney in the United States ensuring them that the prospective customer's account would not be used in contravention of U.S. laws. Apparently, accounts established by the island's attorneys on behalf of exempt companies would not be so carefully screened. In any event, the bankers with whom PSI staff talked insisted that there are very few U.S. citizens with accounts in the Turks and Caicos. This statement contrasts sharply with the testimony of Tom Stocks before PSI where he stated that when Oxford Bank was operating it had approximately 300 accounts of U.S. citizens.[299]

An indicator of the Turks and Caicos growth as a financial center is the increase of attorneys from three in 1980 to 16 in 1983 (including government attorneys). PSI staff interviewed several attorneys to better understand the company formation process and the issues surrounding the question of knowing one's client. The attorneys stated they obtained most of their clients through referrals from other attorneys, accountants, and trust companies, both within the Turks and from other parts of the world. In fact, they often dealt with these third parties as the nominees of the undisclosed principles. Bearer shares further shield the true owners from identification. It is, therefore, quite easy for a shareholder to use for example an attorney in Panama as a nominee in the Turks and Caicos with bearer shares flowing back to the Panamanian attorney. The size and complexity of this shield is limited only by the true owners imagination.

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[297] PSI Hearings, Commodity Investment Fraud II, March 19, 21, 1984, pp. 45.
[298] PSI interview with government officials, September 1983.
[299] Hearings, p. 93.

According to local attorneys, very few corporate clients have bank accounts in the Turks. This again, is in contrast with Mr. Stocks' testimony in the hearing to the effect that:

> At that time, the Turks and Caicos Islands were developing a reputation as an emerging tax haven. And this fact bought a great many U.S. customers to the islands. Many corporate customers of the Oxford Bank were referred to us by Turks and Caicos attorneys.
>
> I would estimate that as many as 1,000 "shell companies" were established in the islands during this time period. These companies may not have been used as business operations both their creation provided business for the banks.

The Turks and Caicos are making concerted efforts to become a significant financial center without attracting the criminal baggage that ruins a country's reputation. The problem, central to the Turks and Caicos, as with all havens, is how to separate the criminal element from the legitimate investors who happen to demand secrecy—for whatever reasons. Unfortunately, there are no easy solutions to this dilemma. But the government of the Turks and Caicos appears to realize this fact and continues to address this fact head-on. In that respect, the Turks and Caicos appear to be on the right track. However, Norman Saunders, Chief Minister of the Turks and Caicos was arrested in early 1985 by U.S. authorities for aiding drug smugglers. What effect his case will have on the Turks and Caicos remains to be seen.

VIII. THE EVOLVING EMPHASIS OF U.S. LAW ENFORCEMENT

INTRODUCTION

When PSI embarked upon this investigation in early 1982, the subcommittee expected to find a somewhat coordinated effort by U.S. law enforcement aimed at the problem of offshore money laundering. The subcommittee was familiar with the successes of Operation Greenback and several lesser known multi-agency investigations. Because of these and the wide spread attention directed toward this problem, the subcommittee anticipated the existence of a central repository of data pertaining to the major offshore issues and cases of the recent past. But no such central data base existed. In fact, with few exceptions, there was virtually no coordinated effort on the part of Federal, much less State, law enforcement to address this problem.

THE GROWING NOTORIETY OF OFFSHORE ACTIVITY

Offshore criminal enterprises have continued to attract international attention during the months since the Permanent Subcommittee on Investigation's hearings. Much of this focus has resulted from the aggressive approach taken by the Treasury and Justice Departments in criminal and grand jury matters, the SEC's stance on insider trading, the State Department's efforts in conjunction with Justice, the SEC and Treasury's efforts to find diplomatic solutions with key havens, and growing congressional interest in the many aspects of the offshore problem.

This increased concern on the part of the U.S. law enforcement community regarding transnational criminal activity is evident in the additional resources aimed at the problem, additional training taking place, and the types of cases being investigated and investigative techniques being used.

ADDITIONAL RESOURCES TARGET THE HAVENS

Operation Greenback was one of the first permanent resource commitments to the investigation of money laundering *per se,* though both DEA and the FBI have had a history of conducting short-term undercover and sting operations which directly or indirectly targeted laundry operations. The interagency efforts used in Greenback have been duplicated by several U.S. Attorneys and the continuing, deep seated crime problem in Miami gave rise to the Vice President's Task Force. This Task Force used Federal and local law enforcement agencies to try to mitigate the chaotic crime conditions in South Florida. Though the Vice President's Task Force was not directly aimed at the money launderers, the pressure of the task force in conjunction with Greenback caused significant disruption in the laundering of narcotics profits in Miami.

The arrest by Greenback agents of several major launderers and the conviction of bank officials whom they had bribed caused numerous drug merchants to turn to a few, large, Colombian-run currency exchange houses. Treasury analysis of currency reports soon revealed the existence of the exchange houses and the operations were closed. The Miami operations of Isaac Kattan and Beno Ghitis-Miller and the successful prosecution in the highly publicized *Orosco* case in New York are examples of these successes.

The heat generated by such increased law enforcement attention caused a dispersal of the launderers from Miami which, in turn, helped prompt the Reagan Administration to form multi-agency drug task forces in key U.S. cities. These task forces are directed by highly experienced prosecutors who draw on all Federal agencies as needed to investigate major organized narcotics traffickers. At this stage, the task force approach seems to have been successful, but more of a track record is necessary.

For the most part, Greenback and the mini-Greenback groups which followed were staffed with pre-existing enforcement resources. The narcotics task forces, however, have come primarily from new enforcement resources. Both the Criminal Section of the Tax Division and the Criminal Division's Office of International Affairs (OIA) at the Justice Department have made significant additions to their staffs. In addition, Criminal Tax, in conjunction with

IRS priorities, has shifted its emphasis somewhat to target cases that involve offshore facilities, i.e., tax shelters, tax protestors and cases arising from the drug task forces.

The aggressive policy exhibited by the Justice Department against recalcitrant havens was demonstrated by the *Bank of Nova Scotia* and *Marc Rich* cases. On the other hand, more diplomatic initiatives suits are evident in the Swiss and Cayman accords. In any event, the dangers posed by unfettered subpoena authority at the Assistant U.S. Attorney level became obvious by 1983. Hence, in a November 1983 message to all U.S. Attorneys, the Justice Department noted that the ". . . uncoordinated use (of subpoenas to obtain offshore records) raises various questions of infringement of foreign sovereignty which can seriously damage United States foreign relations and adversely affect other cases under investigation. . . ." All such subpoenas are now supposed to be cleared through Justice Department headquarters. This is a welcome development. Unfortunately, however, the approach within the Justice Department is still too fragmented; there is far too little interdivisional coordination.

The progressive steps taken by INTERPOL in the last few years are further evidence of hightened concern for the offshore problem. In 1979, the U.S. National Central Bureau of INTERPOL was represented by only two enforcement agencies and had a staff of four. Today the Bureau has over 60 staff representing 12 agencies. The Bureau has brought its communication and technical equipment up to state of the art and uses second generation computers with additional upgrading in the process.

INTERPOL has recently addressed the offshore problem head on. In 1983 the American regional working party met in Curacao to explore what might be done about the mutual problems of international money laundering. The Curacao recommendations which were subsequently approved by the General Secretariat called for member countries to inventory their secrecy laws and to identify the procedures necessary to access information in a criminal investigation. Another significant recommendation was made that the General Secretariat encourage member countries to develop laws to recognize requests from foreign jurisdictions. The remaining recommendations dealt further with the problems posed by "offshore banking".

The working party again met in the Caribbean in mid-1984 at which time they continued to move toward increased cooperation in criminal matters, particularly those covered by haven secrecy laws. Significantly, the 1984 working party meeting proposed model legislation for offshore banking formation and regulation. This legislation is hoped to be of use to emerging havens grappling with legislative content. INTERPOL has obtained the assistance of various banking groups in this endeavor. Countries other than the United States are taking the lead on some of these issues, reflecting the transnational nature of the problems arising from offshore money laundering. A 1985 meeting in Washington, D.C. is planned.

INTERPOL recently established a financial group at the General Secretariat, created specifically to address the problems of financial assets investigations and offshore banking. This group consists of a senior representative of the Royal Canadian Mounted Police, the

U.S. Customs Service and the Internal Revenue Service Criminal Investigation Division.

Two other Federal agencies have added new units in response to the growing complexity of cases involving international money laundering. The DEA recently formed a Financial Intelligence Unit which is staffed with senior agents and analysts. Particular emphasis has been placed on gathering intelligence concerning complex offshore financial networks of major narcotics traffickers. The unit has issued several detailed regional reports on money laundering systems and more reports are expected.

The IRS Criminal Investigation Division has also established several data gathering units in its national office function due to the explosion of the use of offshore havens to evade taxes by all segments of the U.S. population and the complex schemes being used by these evaders (particularly narcotics traffickers, organized crime groups and abusive tax shelter operators).

The value of these units can be demonstrated by the recent investigation of the United States Tax Planning Services, Ltd., Grand Cayman. In mid-1984, the IRS Criminal Investigation Division served 25 simultaneous search warrants on USTPS based upon affidavits filed by agents who penetrated the tax shelter using undercover techniques. The affidavits alleged numerous fraudulent acts by USTPS, all of which were concealed behind haven secrecy laws of the Cayman Islands, the Turks and Caicos Islands, Antigua and other havens. IRS officials firmly believe that the investigation of complex cases such as USTPS would be impossible were it not for the use of undercover techniques, the use of confidential informants and a sophisticated intelligence gathering capability to bring the seemingly disparate pieces of data from hundreds of national and international sources together.

The USTPS file contained the names of 1,500 clients and 1,000 additional persons whom USTPS had apparently contacted. Many of the 1,500 clients "saved" up to $200,000 in taxes in current and prior years, making the total tax loss in this one shelter alone approach $300 million.

In 1984, IRS had about 300 tax shelter criminal investigations ongoing, 40% of which involve offshore havens. In addition, IRS has referred 62 cases to the Justice Department for injunctive action. Had each of these 62 shelters been fully subscribed, 11,000 investors would have accounted for $3.8 billion in lost revenue to the U.S. Govenment. IRS currently has 20,000 tax shelter cases before the U.S. Tax Court, about half of which involve the use of tax havens.

The special units carved out of existing Federal, State and local law enforcement resources or funded by moderate budget increases have accounted for numerous dramatic cases (many of which are referred to in this report) which in turn provide incontrovertible proof of the enormous scope of the offshore problem. Unfortunately, the actual size of the problem will never be known—a reality which greatly complicates enforcement resource allocation. But although the subcommittee is sympathetic with the difficulties enforcement agencies have in quantifying the problem, there is no excuse for the lack of a centralized body of knowledge on offshore criminality. What knowledge exists is not being efficiently disseminated to those who need the information; policymakers, diplomatic negotiators, Federal, State and local law enforcement officials and Congress.

MONEY LAUNDERING ENFORCEMENT TRAINING PROGRAMS

Recent years have seen a growing number of training programs and professional seminars on the issue of money laundering. Justice Department senior attorneys and PSI staff have participated in training seminars for the DEA, IRS, U.S. Customs Service, the FBI, the American Bar Association and seminars sponsored by the Battelle Memorial Institute and the American University for State and local law enforcement officials. Several international conferences have been held in the United States and abroad for attorneys in private and public practice and senior law enforcement officials. While some of these conferences have dealt with the larger issues of trans-national litigation, blocking and secrecy laws have been a prominent part of the agenda.

OTHER ENFORCEMENT EFFORTS

The success of the major offshore financial centers has encouraged other countries to emulate their efforts. Several of these countries instituted laws which were quickly manipulated by bank fraud artists who set up "banks" which they then used to defraud millions from U.S. citizens and companies. The enforcement office of the Comptroller of the Currency is working with these countries in an effort to assist them in preventing such manipulation. Members of the enforcement staff have traveled to many of these countries and worked closely with senior government leaders on this problem.

The State Department has taken a very active role in the protracted and sensitive negotiations with the Swiss, the Bahamians, the Caymanians and other haven countries. State, working closely with other Federal agencies, has had major successes in this extremely difficult area.

The Treasury Department, in addition to its work through its enforcement agencies, has initiated regulations to strengthen Title 31 (The Bank Secrecy Act) by giving Treasury further access to international bank records in the United States and by including gambling casinos under Title 31. The final regulations subjecting casinos to the reporting and recordkeeping requirements of the Bank Secrecy Act have been adopted and will be effective in May, 1985.

The U.S. Customs Service, which along with the IRS has primary enforcement jurisdiction over Title 31 has enlarged its Federal Law Enforcement Center (FLEC) staff to meet the explosion in the number of currency reports being filed. FLEC processes and analyzes both domestic and foreign currency reports and makes the results available to its field offices, IRS and other enforcement agencies. These analyses have been responsible for the initial identification and subsequent prosecution of some of the largest money laundering cases in recent history.

The SEC, in its testimony before PSI, made it clear that secrecy and blocking laws posed a major threat to the U.S. capital markets by allowing U.S. insider traders to profit with impunity. Through the recent U.S.-Swiss accords on insider trading have helped dramatically, the problem still exists with respect to many other havens. To combat this problem, in 1984 the SEC began seeking expert opinion on the feasibility of making entry into the U.S. capital markets an implied consent to waive the secrecy laws of the foreign country involved. Thus a Panamanian or Bahamian bank buying securities on behalf of a nominee would have the implied consent from the nominee by the very action of placing the order. While even the SEC does not see this as a panacea, it should be helpful. The SEC is also seeking expert advice on any other measures which might help resolve the problems posed by blocking and secrecy laws to the U.S. capitol markets.

The last 3 years have seen tremendous changes in the government's and public's awareness of the problems posed by offshore money laundering. As a result, government efforts have shifted and successes have increased. The subcommittee is encouraged by this trend and hopes it will continue.

IX. RECOMMENDATIONS

1. Negotiations of unilateral disclosure agreements intended to alleviate the problem of haven secrecy have been costly, time consuming and unproductive. Bilateral agreements in areas such as narcotics related information and insider trading information offer some hope, but broader multilateral treaties or understandings are preferable.

The subcommittee urges the U.S. Government to aggressively press forward with the negotiation of multilateral treaties or understandings with offshore jurisdictions for the exchange of law enforcement information. As an interim step, the subcommittee recommends the U.S. Government fully explore the feasibility of bilateral agreements such as the recent U.S./Cayman Islands understanding regarding narcotics cases.

Congress and the executive branch, taking into account issues of foreign sovereignty, should consider the imposition of sanctions against those havens who express no interest in treaty negotiations. Such sanctions may include:

a. The requirement that loans from the havens be reportable as income for Federal income tax purposes.

b. The denial of any deduction for Federal income tax purposes for any expense or loss arising out of a transaction entered into, with, or by an entity located in the havens.

c. The requirement that U.S. Corporations report income earned through the havens as U.S. source income.

d. The requirement that U.S. domiciled banks report all transactions between the havens and the banks.

e. The considerations of limitations on direct airline flights to and from the havens.

2. Criminal activity in the United States is unquestionably aided by the use of foreign jurisdictions to divert enormous amounts of illegal profits from the United States. Clearly, billions of U.S. dollars derived from illegal activities are being funnelled offshore. The scope of these illegal activities impact upon virtually all Federal, State and local law enforcement and regulatory functions, yet

there has been no centralized body of knowledge or expertise on the subject of the criminal use of offshore financial institutions. A comprehensive compilation of money laundering techniques uncovered and cases involving the illegal use of offshore institutions would be of enormous benefit to this diverse group of law enforcement officers and regulators. In addition, there is a growing need for a central office which could coordinate and respond to complex questions of international sovereignty and extra territorial jurisdiction posed by foreign secrecy and blocking statutes.

The subcommittee recommends the establishment of a clearinghouse within the existing structure of the Department of Justice to determine what procedures must be used to obtain information, both through formal and informal channels, from haven jurisdictions and to coordiante a U.S. law enforcement policy against the criminal use of offshore tax havens. The subcommittee further recommends that the clearinghouse archive all known money laundering cases with particular emphasis paid to money laundering techniques used and legal issues raised. The clearinghouse data should be accessible by the appropriate Federal, State and local agencies which find themselves confronted with offshore secrecy or blocking statute issues.

3. Various international organizations could be approached for their assistance with respect to the offshore crime problem. The United Nations Congress on the Prevention of Crime and Treatment of Offenders, the Caribbean Community and Common Market (CARICOM) and the Organization of American States all are organizations which could be approached by the United States to assist in resolving the offshore crime problem. The members of these various organizations are likewise affected by the problem and therefore have a common interest with United States in its resolution.

The subcommittee recommends a coordinated, multi-agency effort by the United States to take advantage of international organizations to help resolve what have become pressing problems of international law enforcement.

4. On February 7, 1985, the First National Bank of Boston pled guilty to one felony court under Title 31. That plea has been followed by numerous cases of other banks coming forward to admit that they too had failed to comply with some of the reporting requirements of Title 31. The subcommittee held a hearing on this issue on March 12, 1985. Evidence presented at our hearing and subsequent events indicate that noncompliance with Title 31 is probably widespread. The evidence also indicates that compliance checks of Title 31 by bank regulators has, in some cases, been abysmal.

The U.S. Government must insure that its own house is in order if it is to expect the cooperation of offshore financial institutions and haven governments.

a. The subcommittee recommends that the banking regulators take immediate steps to insure that their examiners are fully knowledgeable in the requirements of Title 31.

b. The regulators should also insure that every regular examination includes sufficient examination procedures to verify compliance with the reporting requirements of Title 31. These steps *should extend beyond "taking the institution's word" that they are in compliance.*

c. Financial institutions should move to insure that all their employees are completely knowledgeable of the requirements of Title 31. They should likewise institute such internal audit and internal security devises as are necessary to insure total compliance with Title 31. The recommendations detailed in the Interim Report of the President's Commission on Organized Crime (October, 1984) should be given careful consideration in this regard.

5. In 1980, the Treasury Department revised the regulations under Title 31 to require the reporting of large currency transactions with foreign banks. This requirement was implemented to provide Treasury with detailed information on the source and destination of international currency flows. While this information is important for law enforcement purposes, it takes on added significance in the policy making and diplomatic arena.

Recent disclosures of rampant non-reporting of these transactions make past reliance on these figures dubious at best. But even if all transactions had been reported, the figures would not give an accurate picture since the Federal Reserve is not required to report its currency transactions with foreign banks. As noted elsewhere in this report, these omissions are material and invalidate the value of the data reported.

The subcommittee recommends that the Federal Reserve be required to report currency transactions with foreign banks in excess of $10,000.

6. The subcommittee has seen ample evidence that money laundering is a rapidly growing phenomenon used by criminal elements to evade detection and prosecution. The laundering of the illicit proceeds of major criminal cartels, is, in effect, the glue that holds these cartels together. It is a major element without which these organizations would literally fall apart. The sophistication of money laundering techniques is such that the act itself can no longer be considered a benign adjunct to other criminal endeavors. The subcommittee believes the very act of laundering funds obtained through illegal acts should be classified as a separate Federal criminal act.

The subcommittee, the President's Commission on Organized Crime and the Justice Department have found that the Right to Financial Privacy Act significantly inhibits financial institutions from reporting suspicious financial transactions to law enforcement agencies.

The subcommitee recommends that the Congress consider and enact S. 1335, entitled the "Money Laundering and Related Crimes Act of 1985." This act contains specific provisions making money laundering a criminal act. The act also amends the Right to Financial Privacy Act to allow financial institutions to provide appropriate records to the U.S. Government when the institution has reason to believe the records contain evidence of violations against financial institutions, supervisory agencies, the Bank Secrecy Act, the Controlled Substances Act and the RICO statutes. The act further *allows such records to be transferred to other Federal agencies where relevant to the receiving agencies jurisdiction.*

7. In March 1985, the subcommittee requested the General Accounting Office to determine whether or not the Treasury Federal Law Enforcement Center is sufficiently funded to allow it to thoroughly analyze the data it receives under Title 31. GAO was also asked to study how effectively the government uses this data. Finally, the GAO was asked to determine how well the bank regulating agencies were monitoring overall compliance with Title 31.

The subcommittee will propose recommendations as appropriate upon completion of the GAO studies.

APPENDIXES

APPENDIX 1

I. LEGITIMATE USES OF OFFSHORE CENTERS

It is essential to understand who uses offshore financial centers and the reasons why, since legislation designed to counter the abuses of offshore banks and companies must be tailored to avoid disruption of the legitimate markets.

The primary beneficiaries of offshore financial centers, particularly through legitimate tax advantages, are multinational corporations. Broadly speaking, there are three ways a multinational corporation uses an offshore center to mitigate taxes: profit creation, profit diversion, and profit extraction.[1]

"Profit creation" refers to the establishment of a commercial business within a low tax territory.[2] Since tax havens are characterized by a lack of manufacturing and industry, this is not the most widely used technique for resorting to tax havens. However, centers such as Hong Kong and Puerto Rico illustrate the opportunities which can be created for corporations interested in profit creation.[3] Although there are many examples of profit creation, a specific example would involve the formation of a company in a low tax haven for the manufacture or "substantial transformation" of goods to be sold for use outside the tax haven. If the goods are not sold for or on behalf of a related party, the selling entity will ordinarily not be considered a foreign based sales company, and therefore escape Subpart F income treatment. This was essentially the case in the De Lorean manufacturing plant.

"Profit diversion" refers to the practice of diverting taxable profits from a high tax country to a low tax country.[4] Major companies use controlled foreign corporations to implement profit-diversion. Assets that are transferred to these controlled corporations can under certain circumstances, be repatriated as loans to U.S. entities. An advantage of this practice is the maintenance of anonymity. Companies also divert income to such entities as holding companies and sales companies. By retaining substantial stock ownership, holding companies may, again under certain circumstances, be used as investment vehicles or as conduits for the collection of income in the terms of dividends, interest, royalties or licensing fees. The controlled company can then distribute funds to the parent, reinvest or lend to affiliates.[5]

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[1] Offshore Corporate Tax Planning", Thomas Kelen, *Multinational Business*, No. 3, 1977.

[2] "Who Uses Offshore Centers? Multinational Companies", John Chown, *The Banker*, April 1977, p. 97.

[3] Ibid.

[4] Ibid.

A specific example of profit diversion is McDermott, Inc.'s use of its Panamanian subsidiary, McDermott International. In October 1982, McDermott, Inc. announced that it would merge with its Panamanian subsidiary, McDermott International, which would acquire all of the shares of the parent company. As the firm's press release indicated, the move was designed to "reduce taxes on foreign earnings and improve operating flexibility so that McDermott could compete more effectively in the world marketplace."[6]

An additional example of profit diversion can be found in *Hospital Corporation of America* v. *Commissioner,* 81 T.C. 520 (1983). HCA, after contracting with the Royal Cabinet of Saudi Arabia to manage the King Fassel Specialist Hospital, transferred the contract to its newly formed Cayman Islands subsidiary. Although the IRS maintained that the profits derived from the contract were allocable to HCA, the Tax Court found the subsidiary legitimate and approved the taxpayer's attribution to it of a considerable amount of taxable income.

The third technique for utilizing an offshore financial center is "profit extraction." Through this method, profits which are taxed in the high tax country are reduced by having a low tax subsidiary charge management fees, royalties, or interest against these profits. However, as Gucci Shops, Inc. discovered in a recent IRS investigation,[7] U.S. government regulation tends to make profit extraction less attractive; it is more effective when used to take advantage of double tax treaties.[8]

Another traditional way for a multinational corporation to use an offshore company is as a "financial vehicle." For example, major banks use offshore financial centers to minimize taxes on loans. Officials at Chase Manhattan Bank explained that Chase has offices in 75 countries and makes loans in over 125 countries.[9] Chase uses branch banking as opposed to subsidiaries, the distinction being that branches are taxed in the consolidated statement of Chase whereas subsidiaries are taxed on their foreign operations in the foreign country with offsets against such taxes in the U.S. As a matter of policy, Chase tries to book loans to their customers in countries where taxes are the lowest in an effort to reduce foreign taxes.

Banks, as well as corporations, are also attracted to offshore centers for the tax deferral prospects. Normally, a bank will operate through a wholly owned subsidiary which enables the parent bank to accrue profits within the subsidiary and capitalize low tax profits, thereby improving the working capital of the offshore subsidiary.

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[5] The abuse of such holding companies by related taxpayers was addressed by Subpart F of the Internal Revenue Code. Subpart F was enacted to tax U.S. shareholders of controlled foreign corporations on their share of foreign profits. A controlled foreign corporation is defined by section 957 as any foreign corporation in which more than 50% of the voting power is owned by a U.S. shareholder. Section 482 enables the Commissioner of the IRS to allocate income and deductions between two or more controlled entities when necessary to prevent tax avoidance.

[6] McDermott Int'l Press Release, October 28, 1982. *See also* Richard Green, "Pack Up All Your Cares and Woe," *Forbes,* January 17, 1983, p. 46.

[7] See Appendix, survey of cases, *United States* v. *Chase Manhattan Bank.*

[8] U.S. Repeals Withholding Tax on Eurobonds", A.S. Pergam, *International Financial Law Review,* August 1984, p. 18.

[9] Interview with Executive Vice President for International Banking, Chase Manhattan Bank, March 31, 1982, conducted by PSI staff.

Also, for many years the use of an offshore financial subsidiary enabled a company to borrow money without withholding tax on interest paid, thereby improving its financial flexibility. With repeal of the U.S. withholding tax in the Tax Reform Act of 1984, it is anticipated that the need for offshore companies, such as those which have proliferated in the Netherlands Antilles, will be greatly reduced.

In addition to accepted legal techniques of minimizing taxes, offshore centers offer users privacy, freedom from currency controls and banking regulations, and higher interest rates on deposits with lower rates on borrowing. Actually, international banks sometimes establish themselves in offshore centers simply to further their international presence.[10]

Whatever the incentive, it is clear that the use of offshore centers is a popular device. To illustrate we can take the country of Bahrain. When Bahrain opened its doors to offshore banks in 1975, the response was substantial. By 1978, 48 banks had been licensed.[11] Today, it is reported that the average OBU in Bahrain has profits of $1 million annually on a balance sheet of $450 million and expenditures of $1 million. Most of the offshore banks are said to have become profitable after only 12 months or less.[12] Bahrain typifies offshore centers by offering several fiscal and regulatory incentives to profit seeking international banks. In Bahrain, banks are exempted from the obligation to maintain reserves with the Bahrain Monetary Agency and are not required to observe formal liquidity ratios.[13] Also, the income of the banks is tax free and no withholding tax is applied to the interest income of the depositor.[14]

II. THE EURODOLLAR MARKET

An important legitimate use of offshore banking is as a vehicle to participate in the Euromarket, or more specifically, the Eurodollar market. Offshore havens are only one facet of the Eurodollar market. In sum, a Eurodollar is a deposit denominated in U.S. dollars which, regardless of ownership, is located at a bank (or on the books of a bank) outside the United States. An example is as follows: A U.S. citizen writes a check on his domestic bank, X, in the United States to transfer $10 to a bank abroad, bank Y. Bank Y has no use for dollars as such and thus holds them in a bank in the United States, perhaps bank X itself, or another. Bank X, if it is holder of bank Y's deposit, acquires a debt thereby payable in dollars to the investor, and as a matching asset (in double-entry bookkeeping) a demand deposit. What has happened in our example is that the domestic bank has merely substituted its liabilities to the non-resident bank Y. "Clearly . . . Eurodollars are not really dollars at all, rather they are claims on dollars." [15] "Euro" arises from the fact that while they may, in fact, be dollars on deposit anywhere in the world—surely in the offshores anywhere—historically they were centered in the city of London market. Banks, or divisions of banks, dealing in Eurodollars (as Y above)—some now prefer the term "Xeno dollars"—are not ordinary commercial institutions for they are not dealing in local money and do not balance local deposits with withdrawals. Rather, the Eurodollar market has created banks that borrow dollar demand deposits and relend them.[16]

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[10] "Who Uses Offshore Centers? International Banks", W. Penman Brown, *The Banker,* April 1977, p. 101.

[11] "Bahrain's Offshore Banking Center", A.G. Gerakis and O. Roncesvalles, *Economic Development and Cultural Change,* V. 31, January 1983, p. 271.

[12] Ibid., p. 275.

[13] Ibid., p. 274.

[14] Ibid., p. 274.

Banks that accept Eurodollar deposits usually make two types of investments: loans and interbank placements.[17] An interbank placement occurs when a bank deposits funds in another bank. The rate at which banks in London offer Eurodollars in the placement market is the London Interbank Offered Rate or LIBOR.

The Eurodollar market differs from domestic banking operations in several ways which make it attractive to borrowers and lenders. First, Euromarket deposits have a fixed maturity and are always paid interest.[18] Second, the Eurodollar market is free from banking regulations which restrict domestic banking activities. For example, in contrast to domestic banks, which must maintain non-interest earning reserves against deposits, there are no reserve requirements imposed on foreign banks against Eurocurrency deposits. As a result, every dollar of deposits can be invested. Also, there is no Federal Deposit Insurance Corporation Insurance assessment associated with Eurodollar deposits, stamp duties on bonds, or currency exchange controls. These lack of restrictions generally translate into lower operating costs, and as a result Eurobanks can maintain profitability with a relatively small spread between borrowing and lending rates. Finally, there are no taxes levied on funds in transit, nor are taxes in the form of licensing fees or other regulatory charges generally very large.[19]

Several factors mark the development and growth of the Euromarket. In the 1980's, the Soviet Union and other Communist countries held dollar balances due to importing and exporting largely in New York. When the cold war caused the Communists to fear a seizure or freeze on these deposits, they were transferred to European banks.[20] Another factor has been the decrease in the use of pound sterling in international financing largely due to British government currency controls. This development, coupled with the increased use of the dollar, led importers to borrow Eurodollars to finance trade.[21] Other important stimuli include the effect of regulations during the tight money years of 1968 and 1969, and capital controls instituted in the 1960's designed to improve the U.S. balance of payments which substantially increased the need for dollar financing outside the United States.[22]

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[15] Blum, R.H., 1984. "Offshore Haven Banks, Trusts, and Companies" p. 29, New York. Praeger.

[16] Ibid.

[17] Stigum, Marcia *The Money Market*, p. 111.

[18] Ibid.

[19] Blum, Op. cit., note 15.

[20] Stigum, Op. cit. MKD p. 105.

[21] Ibid., p. 105.

[22] Ibid., p. 106-107.

Although London has traditionally represented the biggest and most important center of the Eurodollar market other centers have proliferated as a result of high taxes imposed on profits earned in London. To avoid these taxes, booking centers have developed in low tax areas such as Bahrain, the Bahamas and the Cayman Islands. Banks frequently book loans into those centers that have been negotiated in London or New York or some other Euromarket center. They fund these loans by causing the branch to buy money in the Eurodollar market in its own name or with dollars purchased in the name of their London branch.[23]

The actual growth of the Eurodollar market has been astounding. There are two measures with which to gauge the size of the market. One is the 'gross size', which accounts for all foreign currency liabilities including interbank deposits.[24] The more accurate measure is the 'net size' which excludes interbank liabilities within the reporting area. The 'net size' method is generally considered to be more accurate, since interbank payments do not represent credit for ultimate users they do not inflate the figures.[25]

From 1970 through 1981, the average yearly net growth rate of the Eurocurrency market was 27 percent.[26] Given such growth and volume, the Eurocurrency market's importance to the international economy cannot be underestimated.

TABLE 1.—ESTIMATED SIZE OF THE EUROCURRENCY MARKET

[Dollars in billions]

	Gross size [1]	Growth rate (percent)	Net size [2]	Growth rate (percent)
Year:				
1964	$20		$14	
1965	24	20	17	21
1966	29	21	21	24
1967	36	24	25	19
1968	50	39	34	36
1969	85	70	50	47
1970	115	35	65	30
1971	150	30	85	31
1972	210	40	110	29
1973	315	50	160	45
1974	395	25	220	38
1975	485	23	255	16
1976	595	23	320	25
1977	740	24	390	22
1978	950	28	495	27
1979	1,235	30	590	19
1980	1,525	23	730	24
1981	1,860	22	890	22
1982	2,055	10	960	8

[1] Total foreign currency liabilities of banking offices in major European countries, the Bahamas, Bahrain, Cayman Islands, Netherlands Antilles, Panama, Canada, Japan, Hong Kong and Singapore. Statistics prior to 1972 exclude the Netherlands Antilles.

[2] Gross size minus interbank deposits within and between market centers listed in the footnote above.

Sources: World Financial Markets, March 1982:15 and August 1983:15; Dufey, Gunter and Ian H. Giddy. The International Money Market. Engiewood Cliffs, Prentice-Hall, 1978, p. 22.

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[23] Ibid., p. 108.

[24] William Jackson and Arlene Wilson: "International Banking Facilities and the Eurocurrency; CRS Report No. 82-27F, January 8, 1982, p. 8.

[25] Ibid., p. 9.

[26] Ibid., p. 10.

III. PROFITABILITY TO HOST COUNTRY

In a 1979 IMF department study, Ian McCarthy challenged the notion that offshore banking facilities are of great benefit to the smaller domains, an assumption that has induced many of the smaller jurisdictions such as Anguilla or Montserrat to enter into the offshore banking business. McCarthy pointed out that Eurodollars, which are "booked" offshore, never leave the major financial center. The banks, which are merely shells or conduits offer little employment opportunity and, since tax havens do not tax, the only revenue gain is from licensing, which may be miniscule. According to McCarthy, few countries can boast that their national budgets are significantly supplemented by offshore banking activity.

However, although direct revenue benefits derived from the licensing of offshore institutions may not be significant, offshore bank development may be seen by the host country as a means of diversifying its economy. Without question, revenues indirectly produced for the host country by offshore banks and companies can be substantial. For example, Bahrain's policy of licensing offshore banks, instituted in 1975 as part of a broader scheme of diversification,[27] has generated an average annual income of $890 million or about 5% of the GNP of Bahrain, while significantly advancing Bahrain's diversification effort. At the same time, the offshore banking units provide a link with the Eurocurrency market in a time zone more advantageous to the United States investors.[28]

A similar situation exists in the Cayman Islands, which has reported sizable revenue gains through its offshore sector in recent years. [29] as well as in Panama, where bankers estimated in 1982 that the banking sector accounted for 8% of the GNP, with assets of over $40 billion.[30]

Bankers and government officials hesitate to change this lucrative *status quo* unless an actual problem can be demonstrated. In the Netherlands Antilles, which has strongly opposed cancellation of the tax treaty with the United States, the pre-1984 tax arrangement was said to account for approximately 30% of government revenue.[31] In Montserrat, government officials authorities told PSI that "offshore banks mean a balanced budget." Officials indicate that they can find no source of revenue to replace the funds generated by bank licensing. Since it is politically imperative to maintain a balanced budget, the Chief Minister claimed that, given its financial circumstances, Montserrat has no choice but to encourage offshore banking.[32]

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[27] Gerakis, Op cit., note 11, p. 271.

[28] Ibid., p. 290-291.

[29] Cayman government reports indicate offshore revenues (including companies, banks, and insurance licenses) accounted for 5% of the budget in 1969, 17½% in 1975, and 22% in 1980 (roughly equal to U.S. $9.3 million). In 1984 the percentage was roughly the same.

[30] Interview with President of Panamanian Bankers Association, May 1982.

[31] Interview with Netherland Antilles Attaché, Dutch Embassy, Washington, March 29, 1982.

[32] Interview with Permanent Financial Secretary, Montserrat and the Chief Minister, Montserrat.

IV. INTERNATIONAL BANKING FACILITIES

The Eurocurrency market has expanded rapidly since its inception during the early 1960's.[33] In 1982, the market was estimated at $2 trillion [34] with expectations that it would soar to $3 trillion by 1990.

In its incipiency, the Euromarket's growth was catalyzed by the implementation of increasingly stringent interest rate ceilings and reserve requirements by the Federal Reserve Board (FRB). By placing a "lid" on interest rates and raising the reserve requirements, the FRB regulations increased the cost of foreign deposits. American bankers were unable to compete with the interest rates offered abroad and foreign held dollar deposits and loans were "drained off" to London and other European banking centers. These dollar denominated funds form a substantial portion of the current Euromarket.

By the early 1970's, American bankers had become greatly concerned over the loss of revenues and the declining size of their international deposit/lending market share. In an attempt to increase the U.S. banking system's share of the Eurocurrency market, they began lobbying for the establishment of International Banking Facilities (IBFs). At the time, however, the FRB feared a leaking of funds between domestic and international markets which would adversely affect the money supply and ultimately, economic stability. Thus, to insulate the U.S. economy from the possibility of random fluctuations in the U.S. money supply, the FRB supported an IBF system which would be limited in scope and would provide banking services to foreign customers only.[35]

The FRB finally agreed to the creation of IBFs, although with more stringent regulations than the bankers had desired and the first IBFs were opened December 3, 1981.[36]

An IBF is not an institution, but a set of asset and liability accounts segregated on the books of the establishing entity or parent. It may be established by a U.S. chartered depository institution, a U.S. branch or agency of a foreign bank, or a U.S. Edge Act or Agreement Corporation.[37] To establish an IBF, the parent entity must submit a written proposal to the FRB 2 weeks prior to the opening of the IBF's books, and must agree to bide by all the rules and regulations established by the FRB.

The activities of IBFs are not only circumscribed by the provisions in the FRB's Act, but also through other existing Federal and State banking laws and regulations. For example, an established entity may not engage in any type of business through its IBF that it is not already permitted to engage in under its Federal or State charter or license. Also, IBF's are responsible for the payment of all State and local taxes that may be assessed them, for it is within the jurisdiction of each State to determine the tax laws that are to be applied to economic activities within their domain. Thus, favorable tax treatment under State and local statutes is an important factor in evaluating the attractiveness of establishing an IBF within a certain locale. Many States—including New York, Connecticut, Florida, California, Georgia, and Maryland—have passed laws exempting IBF deposits from State and local income tax.[38]

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[33] "International Banking Facilities," Sidney J. Key, Federal Reserve Bulletin, October 1982, p. 565.

[34] Ibid.

[35] Ibid., at 566.

[36] Ibid.

[37] "State Taxation of International Banking Facilities," Howard Gluckman, *International Tax Journal,* Vol. 10, November 1983, p. 42.

The purpose of the IBF's is to allow banking offices to conduct a deposit and loan business with foreign residents, including foreign banks, without being subject to reserve requirements, interest ceilings, or insurance coverage and assessments (FDIC).[39] Originally, U.S. bankers argued that by easing Federal regulations the sovereign risk for the U.S. would be less than for financial centers abroad which in turn would result in a shift of Euromarket deposits to New York and other U.S. money centers. Bankers anticipated that as a byproduct, a sovereign differential between IBF rates and Eurocurrency rates abroad would develop, thereby boosting the earning power of American banks, and allowing business customers to deposit and borrow funds at competitive international interest rates. To date, this differential has not materialized. IBF rates are in line with LIBOR. In fact, some countries, OPEC nations in particular, may feel that sovereign risk is actually increased by placing their dollar deposits in the United States, especially after the Iranian asset freeze by the U.S. government in 1980.

Initially, both the Federal Government and the U.S. banking industry believed that additional tax revenues would be gained through the establishment of IBFs. But, thus far, very little additional tax revenue has been created. U.S. banks and their subsidiaries are subject to Federal income tax on their world-wide earnings. Therefore, a shifting of their assets to U.S. based IBFs does not affect their Federal income tax structure.

The establishment of IBFs by foreign banks in the U.S. has not significantly increased Federal income tax revenues particularly because the earnings of foreign bank activities abroad are not subject to U.S. income tax jurisdiction. To date, non-U.S. offices of foreign banks have shifted smaller amounts of assets to IBFs than have offshore offices of U.S. banks. Morever, additional tax revenues from personal income tax have not materialized since the formation of IBFs has not resulted in creating numerous new banking positions.

Apparently, the larger American banking houses felt that the use of IBFs would decrease operating expenses and increase the efficiency of their international activities by consolidating their international transactions. As a result IBFs would permit the banking principals to phase out their offshore branches. But the act passed by the FRB is more narrowly defined than the proposal for which the banking community had lobbied. Restrictions are imposed upon IBFs that are not applicable to foreign branches U.S. chartered banks.[40] Consequently, the major U.S. banks have continued to maintain their "offshore" branches. Transactions that are IBF eligible are booked in the States, while other activities are still processed through "offshore" facilities.

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[38] Key, Op cit., note 33, p. 566.

[39] "Will Hot Money Spoil Miami?", Nicholas Asheshov, *Institutional Investor*, September 1982.

[40] Key, Op. cit., note 33, p. 565.

Access to the New York Clearinghouse (CHIPS) also posed an initial problem to those entities outside of New York that wished to establish an IBF. Originally, banks and Edge Act Corporations that were not located within New York City were denied direct access rights to CHIPS. This effectively excluded all banks not located in New York City from the Euromarket since all Eurodollar tansactions clear through CHIPS. Until the Clearinghouse issue was resolved, it was not feasible to open IBFs in any other U.S. money center (this partially explains why 50% (197) of the facilities, or 75% ($112.5B) of total assets are located in New York City).

Thus far, the formation of IBFs has not produced a major impact on the U.S. banking system or the Euromarket. The largest component of IBF assets initially resulted from self-dealing. However, during the past 2 years the percentage of assets arising from self-dealing has steadily declined. As of September 1982, claims on foreign banks comprised the largest component of IBF assets. Still, the volume of deposits by foreign banks, at IBFs, relative to the size of the Eurocurrency market, is small. U.S. agencies and branches of foreign banks appear to use the inter-IBF market as a substitute for the term Federal funds market. So far, there has been little trading of overnight funds among IBFs. Approximately 90% of the deposits have a maturity of 14 days or more, typically 1 to 3 months.

Leading bankers in London, Luxembourg, and Basel have indicated that the IBFs have had no noticeable effect on their own bank balances. The U.S.'s share of the Euromarket may steadily grow with time, but to date, the implementation of IBFs has been a greater blessing for the Japanese than for the American banking community. (This is because of the strict regulations limiting the activities of IBFs, and the fact that Japanese banks are not permitted to operate shell branches.[41]) As of September 1982, 123 (31%) of the 395 IBFs established belonged to Japanese banks, while only 229 (58%) were affiliated with U.S. banks.

The future of the IBF and the U.S. share of the Euromarket is unclear.

The major competitor of the United States in today's Eurocurrency market is obviously London. Eurocurrency accounts find London particularly attractive for three reasons: (1) time zone; (2) reputation and experience; and (3) English law. London's time zone is beneficial since most of the Euromarket's liquidity is acquired through dealings with the Middle-Eastern oil producers. As previously noted, U.S. IBFs may suffer a shortcoming when doing business with Middle-Eastern countries, that is the U.S. may not be perceived as a good sovereign risk as a result of the 1980 Iranian asset freeze. However, both of these points are minor. The primary reason for London's attractiveness is its consistent open-door policy, which American IBFs are unable to match because of existing regulatory restrictions. Furthemore, English law is said to be more flexible and well-adapted to Euromarket conditions than is U.S. law.

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[41] "The Argument in Tokyo Over Opening Capital Markets", *Business Week*, May 21, 1983.

European bankers contend that New York's growth as an international banking center for Eurocurrency will remain sluggish. They believe, however, that as the size of the market increases more international businesses will go to New York City.[42] In the meantime, speculation persists that Miami may become the nation's second international banking center.[43] With the resolution of the CHIPS problem and Florida's favorable tax regime, Miami has recently emerged with the fastest growing group of IBFs in the country. Miami bankers report that local IBFs have attracted funds from less politically stable offshore centers. It is estimated that $4 of every $10 deposited in Miami banks comes from abroad, much of it from Latin America. (Estimates of Latin American deposits in Miami are in the $4 billion range.) One senior banking officer in New York said of the advent of Miami's IBFs: "Its going to be the biggest laundering game in history." To date there is no indication that IBFs have served this purpose. Yet, Miami bankers have noted that some customers are reluctant to place money in Miami IBFs, preferring the secrecy of Panama and the Cayman Islands. It is estimated that between $90 billion and $100 billion in Eurodeposits are still located in the Caribbean.

According to FRB's August 1983 Staff Study (p. 124):

> IBFs have not altered the international banking scene to any significant extent except by drawing a larger share of international financial intermediation to the U.S. IBFs are simply another location where non-U.S. residents can conduct banking transactions free of regulation. Such an advantage has long been available in many places, including London, the Caribbean, and other important centers. Therefore, the availability of one more booking location should not have been expected to change things significantly, and indeed it did not.
>
> IBFs are probably best viewed as a small step in the general deregulation of banking.

Despite varying predictions by experts, IBF assets amounted to $192 billion as of December 8, 1983, according to FRB data.[44] Since this amount exceeds deposits in such havens as Panama and Bahrain, it is clear that the impact of IBFs has been substantial and its potential not fully realized.

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[42] Key, Op. cit., note 33, p. 565.

[43] Ibid., p. 567.

[44] International Banking Facilities and the Eurodollar Market," Henry Stevel and Rodney H. Miller, Staff statement of the Board of Governors, Re: Federal Reserve System, August 1983.

APPENDIX 2

A SURVEY OF CASE LAW INVOLVING THE ILLEGAL USES OF OFFSHORE ENTITIES

By affording investors a high degree of financial and transactional confidentiality, offshore and foreign havens have facilitated criminal activity in the United States and elsewhere. Records outside the United States are seldom subject to United States jurisdiction and foreign secrecy laws tend to make it prohibitively expensive and time consuming, if not impossible, to gather information regarding the activities of persons conducting business through foreign entities.

While the nefarious uses of offshore and foreign havens assume many forms, an analysis of case law reveals that these entities are principally used: (1) to "launder" illegal proceeds, primarily those derived through narcotics trafficking; (2) to facilitate tax evasion or avoidance; and, (3) to facilitate investment or other fraud. Below is a survey of case law broken down into such categories. It is important to note that the categories are neither exhaustive nor mutually exclusive.

I. THE USE OF OFFSHORE ENTITIES TO LAUNDER ILLICIT PROCEEDS (PRIMARILY DERIVED FROM DRUG TRAFFICKING)

Kimbrell v. *Rossitto,* No. 33094 (Super. Ct., Middlesex, Conn., March 13, 1984). Rossitto, a government informant, became involved in a series of drug related transactions which left Rossitto indebted to Ellswick, a drug supplier in the amount of $1,000,000. In an attempt to recover that sum, Ellswick, through his agent, coerced Rossitto's mother (who was holding property for Rossitto in constructive trust) into signing over a deed of real estate owned by Rossitto and valued at $275,000 to Ellswick's wholly owned *Panamanian* corporation. In a third party complaint filed by Rossitto against the Panamanian corporation, the court found that the transfer was made under duress and declared the conveyance to be null and void.

In re Grand Jury Proceedings. United States (Twist Subpoena) v. *Bank of Nova Scotia,* 691 F.2d 1384 (11th Cir. 1982), *cert. denied,* 103 S. Ct. 3086 (1982). The Bank of Nova Scotia was held in contempt for failing to comply with a grand jury subpoena served on their Miami agent which requested the account records of Robert Twist, the Lesser Antilles Trading Company, and the Latco Development Corporations, from the bank's *Bahamian* branch. The bank's refusal was premised on the Fifth Amendment and on its potential criminal liability in the Bahamas for disclosure of confidential information. The district court engaged in a balancing test under the Restatement of Foreign Relations and enforced the order, finding U.S. criminal enforcement interests to outweigh Bahamian secrecy interests. The 11th Circuit affirmed. (*Nova Scotia I*)

In re Grand Jury Proceedings. United States (Brady Subpoena) v. *Bank of Nova Scotia,* 722 F.2d 657 (11th Cir. 1983). The United States District Court for the Southern District of Florida ordered a *Canadian* bank, having branches in the United States, to comply with a grand jury subpoena requiring the production of bank records located in Nassau, *Bahamas* and Georgetown, *Cayman Islands.* While the bank claimed that it was protected from disclosure by secrecy law, the district court found the bank in contempt of its order. The bank was fined $25,000/day until it released the records—a total of a $1.25 million fine against the bank. The Court of Appeals remanded the case for further proceedings. After a hearing, the district court affirmed its earlier finding and on appeal the 11th Circuit Court of Appeals affirmed 740 F.2d 817 (1984). The Supreme Court denied *certiorari* in January 1985. *Nova Scotia II).*

United States v. *Beltempo,* 675 F.2d 472 (2d Cir. 1982), *cert. denied,* 457 U.S. 1135 (1982). Defendants were convicted for their participation in an elaborate drug conspiracy involving the laundering of illicit profits through a *Swiss* bank account. The convictions were affirmed on appeal.

United States v. *Bertman,* 686 F.2d 772 (9th Cir. 1982). Phillip Bertman, seeking the approval of his plan to import Coors beer into Hawaii, attempted to bribe Liquor Control Administrator Eugene Carson. In cooperation with the Honolulu Police Department and FBI, Carson pretended to succumb to Bertman's attempted bribes. Taped recordings of that meeting, admitted into evidence, revealed Bertman's bribes, including a $500,000 payoff which was to be "laundered" through a bank account in the *Bahamas.* Bertman was indicted on December 13, 1978, for violations of the Travel Act and was convicted a year later. The conviction was affirmed on appeal.

United States v. *Brown,* Cr. No. 83-87-CR-T-8 (M.D. Fla. 1983). Defendants were convicted in a sophisticated import, distribution and money laundering conspiracy involving multi-ton shipments of marijuana. The case involved the use of the Washington International Bank and Trust, *Cayman Islands,* British Bank of Commerce, *Belize,* and the National Bank of *Costa Rica* as well as numerous domestic banks. Also involved were a *Luxembourg* company which owned all or part of companies located in Florida, Delaware, Colorado, New Jersey and the *Channel Islands,* and a *Panamanian* company with offices in Freeport, *Bahamas* which owned corporations in the *Netherlands Antilles* and *Luxembourg.* The indictment charged that the defendants violated drug, fraud, conspiracy, currency, and Travel Act laws in generating millions of dollars in cash which were laundered through Las Vegas casinos and offshore havens.

United States v. *Browning,* 723 F.2d 1544 (11th Cir. 1984). Donald Raulerson and his co-conspirator John Paul Browning attempted to launder illegal drug profits through an undercover FBI organization called C.R.V. Associates (CRV). Over the course of 16 months, Raulerson brought over $4,000,000 to CRV. Raulerson and Browning also used CRV to open an account in the *Cayman Islands* and to transfer funds to banks in *Panama.* Browning was convicted of tax evasion. Panamanian authorities seized $1 million at the request of the United States but later released it when evidence needed to continue to hold the money was not forthcoming. Browning's conviction was affirmed by the 11th Circuit. (See also *United States* v. *Shapiro, infra.*)

United States v. *Jose Antonio Fernandez* (indictment filed December 11, 1984; Cr. No. 84-853-CR-JWK). On December 11, 1984, an indictment was returned charging Jose Antonio Fernandez and five others with conspiracy and participation in a vertically integrated marijuana smuggling syndicate whose purpose it was to import and distribute more than 600,000 lbs. of marijuana, launder the proceeds generated by the drug operations through a variety of domestic and foreign entities, and thereafter invest the drug money in legitimate businesses in the United States. According to the indictment, defendants created more than 30 business enterprises and shell companies here and in *Panama* and attempted to evade the currency transaction reporting requirements by surreptitiously obtaining operational control of the Sunshine State Bank of Miami, arranging the acquisition by utilizing a Panamanian citizen as a nominee owner.

United States v. *Five Hundred Thousand Dollars,* 730 F.2d 1437 (11th Cir. 1984). In November, 1981, the government seized two different sums of money allegedly derived from drug transactions. The $900,000 in unclaimed money, which was obtained during an undercover FBI investigation involving money laundering in Miami, was subsequently forfeited to the United States. Some 8 months later, Arturo Fernandez claimed that he had lost the money in his business of exchanging pesos (from a *Colombian* bank) for United States currency. The district court found that Fernandez was not the owner of the funds and had no standing to claim ownership. Thus, it denied his motion to set aside the court's default judgment. On appeal, the 11th Circuit similarly held that Fernandez had no grounds for possession and affirmed the lower court's decision.

United States v. *Four Million Two Hundred and Fifty-five Thousand, Six Hundred and Twenty-five Dollars and Thirty-Nine Cents,* 551 F. Supp. 314 (S.D. Fla. 1982). In a civil forfeiture action brought by the government against two large sums of money, the government demonstrated that the money was part of a large scale money laundering scheme related to narcotics trafficking and forfeitures were ordered. In the scheme, a *Colombian* businessman, Beno Ghitis-Miller employed a Miami resident, Eisenstein, to physically deliver cash deposits to his company's (Sonal) account in a Miami bank. Over $240 million was deposited in a period of less than 8 months. The bank asked for and received enormous "fees" (e.g., $300,000 per month) to accept the deposits. Defendants were convicted of conspiracy and the felonious failure to file currency transaction reports in violation of 31 U.S.C. 1315. On appeal, the 11th Circuit reversed, finding the district court erred in excluding defendant's attorney's testimony bearing on the issue of whether the defendant complied with full disclosure requirements. (See also *United States* v. *Sonal Corporation, infra.*)

United States v. *Garfield Bank,* Cr. No. 81-71 (C.D. Cal. 1981). The Garfield Bank of Montibello, California, its president and others, were indicted for conspiring with Nathan Markowitz, a drug attorney, to provide money laundering services for narcotics traffickers. The funds were delivered to Garfield Bank, wired to a trust account in the Bank of *Bermuda,* then wired back to the U.S. in the form of loans. As a means of secreting the identity of the traffickers, the Bermudian trust accounts were controlled by fictitious "investment advisor" companies created by Markowitz in *Panama* and *Liberia.* The bank and co-conspirator Gabriel pled guilty; the bank was fined $309,108 and Gabriel, due to his age, was given probation. Markowitz was murdered before the indictment was returned.

United States v. *Govern,* Cr. No. 82-3-Cr-OC (M.D. Fla. 1982). Govern and others were convicted of laundering a total of $4.1 million in illicit drug money through corporations in the *Caymans* and *Netherland Antilles.* Govern executed an unsecured promissory note in favor of Zandra Holdings, Inc., an offshore entity, in the amount of $1.6 million, which was subsequently invested by Zandra in Govern's business. Another $2.5 million in drug money, purportedly the proceeds of a loan from Mexivest, N.V., an Antilles corporation, was invested in other activities of Govern. The case was affirmed by the 11th Circuit in July, 1984.

United States v. *Great American Bank,* Cr. No. 82-720-CR-EPS (S.D. Fla. 1982). The bank and others were indicted for their participation in a money laundering scheme involving over $96 million in illicit drug profits. The bank accepted large sums from traffickers, failed to file accurate currency transaction reports with the Internal Revenue Service and subsequently transferred the funds to accounts in Zurich, *Switzerland* (Swiss Bank Corporation), *Panama* (Banco De Iberamerica), and Lima, *Peru* (Banco Internacional, Banco Del Credito, Bank of Tokyo). On April 16, 1984, the Great American Bank pled guilty.

United States v. *Keller,* 451 F. Supp. 631 (D.P.R. 1978). Defendants were charged with narcotic trafficking offenses after the seizure of their ship in seas north of Puerto Rico. The district court found that the vessel, which was owned by a *Cayman Islands* company, Caribbean Diversified Concepts, Ltd., in reality belonged in whole or in part to U.S. citizens and was therefore subject to the special maritime jurisdiction of the United States.

United States v. *Lee,* 743 F.2d 1240 (1984). Defendants were indicted for substantive and conspiracy marijuana offenses. On appeal the conviction in the district court in the Western District of Missouri as to defendants Jeffrey Lee and James Nettle was affirmed. Evidence elicited at trial indicated that defendants' periodic trips to the *Cayman Islands* were for the purpose of obtaining banking support and expense money to finance the smuggling operation.

United States v. *Long,* 88 F.R.D. 701 (W.D.Pa. 1981). Long and several co-conspirators were indicted for their alleged participation in a drug smuggling scheme operating out of Jamaica, Colombia, Miami, Pennsylvania and Alabama. Anthony Bowe, an officer of Columbus Trust, Nassau, *Bahamas* was purported to have assisted in concealing the source of the profits by laundering money through Bahamian corporations and transferring the funds to Miami corporations formed to receive them.

In re Grand Jury Proceeding. Nigro v. *United States,* 705 F.2d 1224 (10th Cir. 1982), *cert. denied,* 103 S. Ct. 2087 (1983). Edward Nigro, in refusing to testify before a grand jury, invoked the Fifth Amendment on the grounds that the matter would incriminate him under foreign non-disclosure laws. The questions which Nigro refused to answer concerned the illegal laundering of drug profits through certain unspecified offshore banks and corporations. The Court of Appeals enforced the district court's contempt citation.

United States v. *Eduardo Orozco-Prada,* 732 F.2d 1076 (2d Cir. 1984). Defendants' convictions of various offenses stemming from a money laundering operation and the seizure of a vessel containing marijuana were affirmed in part; judgment withheld in part. During a 4-year period Eduardo Orozco-Prada with his brother Humberto Orozco-Prada and their associates, "laundered" over $150,000,000 through an organization called Cirex International. The organization received large amounts of cash from outside the country and deposited amounts of cash in various bank accounts maintained by Eduardo Orozco-Prada in his own name, the names of his associates and in the names of several *Panamanian* corporations.

United States v. *Rittenberg,* Cr. No. 80–02565 (S.D. Cal. 1980). Defendants were charged with importing tons of marijuana from Mexico into California through an intricate drug conspiracy. Illicit proceeds were laundered through various corporations formed in *Liechtenstein, Switzerland,* and the *Bahamas,* then redistributed in the form of loans to the "clients" of those entities.

United States v. *Ignacio Edmundo Sanchez,* Cr. No. 83–291A (Slip Opinion) (N.D. Ga., April 13, 1984). Sanchez and other defendants were arrested on November 9, 1983, and charged in a ten-count indictment alleging their participation in a scheme to launder moneys derived from the sale of narcotic substances. The indictment alleged that as part of the scheme Sanchez attempted to circumvent the bank's required filing of currency transaction reports by depositing less than $10,000 in various branches of the same bank. At a later jury trial, Sanchez, who by that time had served 8 months, was acquitted. (An action for forfeiture of the $300,000 seized during the arrest was being litigated, in 1984.)

United States v. *Sand,* 541 F.2d 1370 (9th Cir 1976), *cert. denied,* 429 U.S. 1103 (1980). Profits derived from illegal drug sales were laundered by transfers from the United States to secret accounts in the *Bahamas* and from there to other accounts in *Switzerland* (Paravicini Bank of Berne, later known as the Metropolitan Bank). Attempts to suppress Sand's bank records were unsuccessful and Sand, along with his co-defendant, was convicted of conspiracy to defraud the U.S. in the collection of taxes and narcotics trafficking. The conviction was affirmed on appeal.

United States v. *Shapiro,* 531 F. Supp. 98 (S.D.Fla. 1982). During a 3-month period in 1981, the FBI conducted an undercover investigation to disclose the "laundering" of drug money in Florida. The investigation operated under a fictitious organization called C.R.V. Associates, and accepted customers by referral only. A subject of this investigation, Bernard Shapiro, was convicted of conspiracy and attempt to distribute over 1,000 pounds of marijuana. (See also *United States* v. *Browning, supra.*)

United States v. *Sonal Corporation* (S.D.FLA. 1981). Sonal Corporation, a *Colombian* money exchange, was prosecuted for laundering illicit funds derived from a Colombian drug smuggling operation through its account at Capital Bank in Miami, Florida. The district court approved the forfeiture of the Sonal account totaling $8.5 million, the largest drug cash confiscation in history. (See also *United States* v. *Four Million Two Hundred and Fifty-five Thousand, Six Hundred and Twenty-five Dollars and thirty-nine Cents, supra.*)

United States v. *Sterling,* Cr. No. 82-86M (W.D. Wash. 1982). Robert Sterling was charged with laundering proceeds from a multi-million dollar marijuana smuggling enterprise through Heusser Bank in *Switzerland.* U.S. authorities requested his bank records but the account was blocked by the Swiss. (U.S. authorities also had evidence that Sterling had financial assets in *Liechtenstein* and the *Cayman Islands* but were generally unable to ascertain their amounts.) Sterling was found guilty and ordered to forfeit all illegal assets.

United States v. *Tobon-Builes,* 706 F.2d 1092 (11th Cir. 1983). Defendant was convicted of concealing the existence and transfer of over $185,000 as part of an alleged scheme to launder proceeds from drug trafficking. Defendant and his female companion purchased approximately 21 cashier's checks in amounts less than $10,000 from 11 different Florida financial institutions, thereby avoiding the filing of required currency transaction reports. The conviction was affirmed on appeal.

United States v. *Toombs,* (E.D. Va. 1982). Toombs and 19 other individuals ran a $75 million marijuana-hashish smuggling operation, laundering $30 million through dummy domestic and foreign entities (*Cayman Islands, Bahamas*) and offshore banks (including the Bank of Nova Scotia, Cayman Islands).

II. THE USE OF OFFSHORE ENTITIES TO FACILITATE TAX AVOIDANCE OR EVASION

Hospital Corporation of America v. *Commissioner,* 81, T.C. 520 (1983). Hospital Corporation of America (HCA) contracted with the Royal Cabinet of Saudi Arabia to manage the King Fassel Specialist Hospital. For the purpose of negotiating and performing the contract it formed a *Cayman Islands* subsidiary. Although the Tax Court held that the Cayman Island's subsidiary was not a "sham" corporation, it found that a portion of its profits were not properly allocable to HCA.

In re Grand Jury 83-4 (FL), (S.D. Fla. No. FGJ 83-4 (FL)). Ian Falconer, an English attorney practicing law in the *Cayman Islands,* was served with a Grand Jury subpoena while touring the United States. Although Falconer was not the target of the investigation, he possessed client-related documents which shed light on the jury's tax fraud investigation. When Falconer, rather than complying, moved to quash the subpoena, the U.S. Attorney's office requested an arrest warrant.

Koehring Co. v. *United States,* 583 F.2d 313 (7th Cir. 1978). Koehring, a Wisconsin firm engaged in the manufacturer of heavy construction equipment, attempted to shield Subpart F (26 U.S.C. 951 undistributed income) tax liability of a subsidiary *Panamanian* company by entering into an arrangement purportedly giving control of the subsidiary to an *English* corporation. The district court held, and the 7th Circuit affirmed, that for the year in question the English corporation's control was nominal and not sufficient to avoid Subpart F tax liability for plaintiff.

McHan v. *Grandbouche,* 99 F.R.D. 260 (D. Ka. 1983). Grandbouche and other defendants induced the plaintiffs to make payments to them in return for a guarantee that the plaintiffs would be able to avoid paying income taxes. The defendants represented that the funds would be concealed in foreign trust arrangements in *Switzerland, Belize,* and the *Turks and Caicos Islands.* The plaintiffs, who had been charged with tax evasion, sued Grandbouche for civil fraud. The district court held, *inter alia,* that the claim of plaintiffs was not certifiable under Rule 23.

Nat Harrison Associates, Inc. v. *Commissioner,* 42 T.C. 601 (1964). A domestic partnership entered into three contracts for the construction of missile facilities in the Caribbean. It assigned the job of performing the work to a newly formed *Panamanian* corporation owned by the partners, and transferred all its assets including its contracts to a domestic corporation. The Commissioner's reallocation of a part of the net profit derived from the contracts to the domestic corporation was upheld.

People v. *Wilson,* Cr. No. A379065 (Super. Ct. Cal. 1982). Wilson was indicted for masterminding a huge child pornography ring, supposedly handling 80% of child pornography in the country, and said to gross over $525,000 a year. Customer's payments were funneled into secret bank accounts in the *Cayman Islands* and *Switzerland.* Wilson was found guilty in June, 1984, of distributing pornography, sentenced to a 10-year prison term, and fined $20,000.

In re Grand Jury Subpoena Directed to Marc Rich, Cr. No. M–11–188 (Slip Opinion) (S.D.N.Y. December 13, 1983). Marc Rich and Co., A.G. (MRCAG), intentionally structured its business to avoid United States jurisdiction. In a motion to quash a grand jury subpoena, company officials claimed that its American subsidiary was not a "puppet" agency to the *Swiss* branch and conducted its affairs at arm's length with the Swiss principal. In enforcing the subpoena the court held that the interest of the United States in investigating violations of its tax laws far outweighed MRCAG's interest in avoiding possible disclosure of business secrets. In June 1984, the Second Circuit upheld the decision to impose a $50,000/day contempt fine which lasted for more than a year. Marc Rich and Co., was indicted and pleaded guilty to criminal tax charges, agreeing to pay a settlement with an estimated value of $200 million in October, 1984.

Ryan v. *Commissioner,* 517 F.2d 13 (7th Cir. 1975), *cert. denied* 423 U.S. 892 (1975). As part of a massive criminal tax investigation conducted for more than 10 years, the IRS charged Ryan with tax evasion and issued interrogatories seeking information regarding any relationship between Ryan and Commercial Credit Bank of Zurich, *Switzerland.* Ryan asserted his Fifth Amendment privilege and the Tax Court directed petitioner to answer. See 58 T.C. 107 (1972). The Court of Appeals dismissed petitioner's interlocutory appeal for want of appellate jurisdiction.

Tussaud's Wax Museum's Inc. v. *Commissioner,* 25 CCH Tax Ct. Mem. 1081 (1966). Tussaud's, Inc., operated a wax museum at the Seattle World's Fair. The wax figurines were leased from an unrelated California corporation. Under a plan devised by Tussaud's shareholders, a *Netherlands Antilles* corporation was to hold title to the figurines and lease them to Tussaud on a percentage royalty basis to avoid American and Canadian taxes on the royalty payments. The Tax Court upheld the Commissioner's assessment of additional taxes owed by Tussaud.

United States v. *Baskes,* 442 F.Supp. 322 (N.D. Ill., 1977), *aff'd,* 649 F.2d 471 (7th Cir. 1980), *cert. denied,* 450 U.S. 1000 (1982). Defendant was convicted for his role in tax fraud scheme consisting of a conspiracy to treat $700,000, a portion of the purchase price of a Reno office-apartment complex and hotel, as if it were payment for a mining claim (eventually found to be worthless). The scheme involved the use of Castle Bank and Trust Company, Nassau, *Bahamas* and a *Netherlands Antilles* company associated with the bank. The district court rejected defendant's post-trial suppression claims, which were largely based upon alleged misconduct of IRS in the well known Castle Bank "brief-case incident".

United States v. *Berger,* 325 F. Supp. 1297 (S.D.N.Y. 1971). Sol Berger, president of Colonial Corporation of America was convicted under 18 U.S.C. § 2 and 26 U.S.C. § 7201 of the willful evasion of income tax owed by Colonial. The court found that Berger had, on numerous occasions, debited to the books of Colonial expenses for material properly attributable to Colonial's wholly owned subsidiary, Colonial Shirts of Jamaica, Ltd., a tax exempt offshore entity incorporated in *Jamaica.*

United States v. *Chase Manhattan Bank,* 84–1 CCH 1984 Stand. Fed. Tax Rep. § 9323 (S.D.N.Y. March 27, 1984). A summons arising out of an IRS investigation of Gucci Shops, Inc., and Aldo Gucci, was served on the Chase Manhattan Bank seeking information on accounts maintained by Garpeg, Ltd., a *Hong Kong* corporation, including information maintained at the Bank's Hong Kong branch. Over the course of 3 years, Gucci shops allegedly made $900,000 in payments to Garpeg claiming these payments as deductible management services. The U.S. Tax Court enforced the summons under its interpretation of an exception to the Hong Kong common law of confidentiality and its conclusion that United States interests required disclosure under Restatement § 40 of Foreign Relations Law.

United States v. *Clough,* 77–2 CCH 1977 Stand. Fed. Tax Rep. § 9523 (April 20, 1977). From 1965 to 1971, Clough, through the use of various aliases, attempted to evade the collection of approximately $262,000 in income taxes. After the commencement of an investigation by the IRS, Clough began to transfer his assets from bank accounts in California to financial institutions in the *Bahamas, England, Canada* and *Mexico.* Concern that the defendant might flee prompted the government to move the court for a writ requiring defendant's incarceration pending dismissal or forfeit of the sum. *(ne exeat republica).* The writ was granted.

United States v. *Dahlstrom,* 713 F.2d 1423 (9th Cir. 1983). Defendants, who designed, promoted, and instructed participants in the use of tax shelter programs using foreign trusts, were convicted of aiding and abetting the preparation and presentation of fraudulent income tax returns in violation of 26 U.S.C. § 7206. On appeal, their convictions were reversed on the ground that the legality of the tax shelter program was completely unsettled on the dates alleged in the indictment. (For a discussion of the scheme see 713 F.2d at 1425.)

United States v. *Eisenberg,* (N.D. Ill. 1981). Chicago lawyer Calvin Eisenberg was charged with using a secret trust account at the Castle Bank and Trust, Ltd., Nassau, *Bahamas* together with two Bahamian companies, to facilitate a tax fraud scheme. The case arose out of Project Haven.

In re Grand Jury Proceedings. United States v. *Field,* 532 F.2d 404 (5th Cir. 1976), *cert. denied,* 429 U.S. 940 (1976). Anthony R. Field, a non-resident alien and director of the Castle Bank in the *Cayman Islands,* refused to testify before a Miami grand jury investigating possible criminal tax violations. Asserting his Fifth Amendment privilege, Field claimed that by divulging the requested information, he would subject himself to criminal liability under the bank secrecy laws of the Cayman Islands. The court found that the need for a grand jury to obtain relevant evidence outweighed Field's possible criminal liability and cited Field for contempt. On appeal the order was affirmed.

United States v. *First National Bank,* 699 F.2d 341 (7th Cir. 1983). The Internal Revenue Service attempted to enforce a summons requesting depositor information from a *Greek* branch of defendant bank. The branch withheld the information, relying on strict Greek secrecy laws which impose criminal liability for the disclosure of confidential information. The Circuit Court, using a balancing test, reversed the lower court's decision and refused to order the enforcement of the summons, but remanded the cause to determine if the bank had made a good faith effort to secure the information.

United States v. *Ghidoni,* 732 F.2d 814 (11th Cir. 1984). Defendant, Lawrence Ghidoni, was indicted in Florida for tax evasion. The government claimed that Ghidoni diverted funds to the Bank of Nova Scotia in the *Cayman Islands* while Ghidoni maintained that he received the money in the form of loans from foreign clients. The government issued a subpoena to the bank's Miami branch, which refused to comply due to possible criminal liability under the Cayman's Bank Secrecy Act. The government then obtained a district court order compelling Ghidoni to sign a consent directive to the bank, which would release the records. When Ghidoni refused to sign he was held in contempt. The 11th Circuit affirmed by a 2–1 vote, rejecting Ghidoni's Fifth Amendment claim on the grounds that there was no "testimonial communication."

United States v. *Hajecate,* 683 F.2d 894 (5th Cir. 1982). On January 21, 1981, a Texas grand jury returned an eleven-count indictment charging Hajecate, his brother, and one other defendant with violations of Federal criminal laws stemming from a scheme to conceal the Hajecates' interest in an offshore bank account. The scheme allegedly involved the obstruction of IRS tax collection efforts, false statements on income tax returns, failure to report financial transactions between persons in the U.S. and foreign institutions, and unreported transfers of money between the U.S. and the *Cayman Islands*. On February 25, 1981, a superseding indictment covering the same scheme was filed. The defendants sought bills of particulars and moved for its dismissal. The district court subsequently dismissed all eleven counts as "facially invalid" and the government appealed. The 5th Circuit, noting that the proper remedy for a bill of particulars inconsistent with an indictment was not dismissal of the indictment but clarification of the bill, affirmed in part and reversed in part and remanded.

United States v. *Kilpatrick,* Cr. No. 82–CR–222 (Slip Opinion) (D. Col. August 25, 1983). William A. Kilpatrick and several co-conspirators, including the Bank of Nova Scotia, were indicted for their participation in fraudulent coal tax shelters and methanol tax shelters, which produced over $122 million in fraudulent tax deductions for investors and $27 million in profits to defendants. The Kilpatrick-owned corporations in the *Cayman Islands,* which purportedly loaned the tax shelter partnerships working capital, were allegedly intentionally undercapitalized. In an apparent cover-up effort, defendants allegedly engaged in an intricate "checkswapping" scheme so that a sufficient balance would appear at all times in the accounts. On September 25, 1984, the court dismissed the charges, ruling that "prosecutors and investigators had 'knowingly and purposefully' committed 'numerous abuses of the rules' of Federal court procedure 'and constitutional principles.' " (See, "Justice Department and the I.R.S. Rebuked by a Federal Judge," *New York Times,* September 26, 1984.)

United States v. *Landsberger,* 692 F.2d 501 (8th Cir. 1982). Defendant was permanently enjoined from offering his "Foreign Tax Haven Double Trust" plan. The Court of Appeals affirmed the district court's finding that the plan was "merely a sham created to aid individuals in the illegal avoidance of tax on personal services income."

United States v. *McDevitt,* Cr. No. 4–82–70 (N.D.Tex. 1982). McDevitt and others were indicted for defrauding insurance companies and tax fraud. Defendants, through Union Commerce Bank and Trust, in *Anguilla,* West Indies (owned by defendants), falsified loan letters and financial statements, and overstated assets. In the tax fraud scheme, McDevitt's *Bahamian* based company, Interamerican Indemnity, Ltd., solicited clients for business consultations which in fact never occurred. McDevitt was sentenced to 3 years in jail and fined $2500. His appeal was dismissed.

United States v. *Malnik,* 348 F. Supp. 1273 (S.D. Fla. 1972). The government attempted to enforce an IRS summons which requested oral testimony and the production of records by Malnik. The summons was directed specifically at *Swiss* bank accounts and *Bahamanian* corporations controlled by Malnik. The district court agreed with Malnik's Fifth Amendment objection and refused to enforce the summons.

United States v. *Mastropieri,* 685 F.2d 776 (2d Cir. 1982), *cert. denied,* 103 S. Ct. 260 (1982). Defendants appealed their convictions on tax evasion charges. The Second Circuit affirmed, finding a pattern of unusual financial transactions, including trust accounts set up at Castle Bank and Trust Company, a major *Bahamian* bank.

United States v. *Osserman,* 82-1 CCH Stand. Fed. Tax Rep. § 9315 (D. Mass. March 30, 1982). Osserman and other producers of the Broadway Hit *Annie,* were indicted for their involvement in a fraudulent tax shelter scheme, which amounted to $20 million in lost revenues. Defendants allegedly created front corporations and sham limited partnerships to accommodate investors seeking to avoid personal tax liabilities, set up "straw" general partners for each limited partnership, and used transactions conducted at Cayman National Bank and Trust, Ltd., located in the *Cayman Islands,* to falsely represent cash contributions to the limited partnerships.

United States v. *Parker,* Cr. No. 81-CR-122 (D.Col. 1981). Parker was charged with tax fraud and the preparation of false income tax returns, which resulted in $40 million in lost revenues. Parker sold investments in foreign gold mines to American citizens whose investments were to be matched four times by foreign concerns. Records from Banque de Paris et des Pay Bas, Zurich, *Switzerland,* and Barclays Bank, Georgetown, *Grand Cayman,* showed funds were misappropriated by Parker. Records from Banca Popular de Modena, *Italy* and Allgemeine Deutsche Credit Ansalt, Frankfurt, *Germany* showed that the checks were bogus.

United States v. *Phillips Petroleum Co.,* 435 F. Supp. 622 (N.D.Okla. 1977). Phillips Inc. and three other defendants sought to dismiss conspiracy charges alleging breach of a plea bargain. The indictment alleged that Phillips had improperly failed to record $2.6 million concealed in *Swiss* bank accounts (chiefly Bank Leu, Zurich), where the money would be available for confidential disbursements to foreign entities and for other purposes. Defendants' motion was granted.

United States v. *Prudden,* 424 F.2d 1021 (5th Cir. 1970). The 5th Circuit reversed and remanded the district court's order suppressing certain statements made and documents furnished in a tax evasion investigation. Defendant's *Bahamian* company was suspected of skimming profits off of its Florida subsidiaries.

United States v. *Quigg,* Cr. No. 81-41 (D.Vt. 1980). Roger Quigg was charged with Federal tax evasion. The district court ordered a New York branch of *Canadian* Imperial Bank to produce records located in the *Bahamas* which would assist in the government's case. Since enforcement of the subpoena was conditional on Quigg's consent, the court issued an order compelling Quigg to execute a consent form.

United States v. *Sans,* 731 F.2d 1521 (11th Cir. 1984). Leon Cohen, his bookkeeper Fred Sans, and several Palm State Bank (Palm Harbor, Florida) officials were indicted on various tax evasion charges including failing to file currency transaction reports. Cohen's case was severed due to his illness, but the remaining defendants were convicted in this attempt to launder illegal proceeds which had been obtained by defrauding Leslie Atkinson, a convicted drug dealer then serving a Federal sentence in Atlanta. In one specific instance cited by the court, Cohen and Sans deceived Atkinson by wiring $260,000 from her *Grand Cayman* account to a

Canadian bank and then to an account in San's name in Florida. The 11th Circuit upheld the convictions.

United States v. *Scotto*, 641 F.2d 47 (2d Cir. 1980). Scotto, then president of Local 1814 of the International Longshoreman's Association, was convicted of RICO violations, tax evasion, and accepting illegal payoffs in excess of $250,000 (Taft-Hartley). Scotto allegedly received over $250,000 during a 3 year period from six separate waterfront businesses employing ILA members, in return for his help in reducing fraudulent workmen's compensation claims, acquiring new business and maintaining existing customers. The money was wired by a Philadelphia bank to a bank in Geneva, *Switzerland*, and then wired back to Scotto's account at a private New York Bank. Scotto's conviction was affirmed on appeal. (See *Wall Street Journal* article, October 29, 1979.)

United States Steel Corp. v. *Commissioner*, 617 F.2d 942 (2d Cir. 1980). United States Steel, a vertically integrated producer, incorporated a wholly owned subsidiary with its principal place of business in Nassau, *Bahamas* to charter vessels for the transportation of ore from Venezuela to the United States. Since the subsidiary was subject to a mere 2.5% excise tax it was, in effect, an offshore tax shelter. The Commissioner's reallocation of income from the subsidiary to parent under 26 U.S.C. § 482 was, in part, upheld.

United States v. *Vetco, Inc.*, 644 F.2d 1324 (9th Cir. 1981). Vetco International, A.G. (VIAG), a wholly owned *Swiss* subsidiary of Vetco, Inc., was charged with tax evasion. The IRS found that the acquisition of VIAG subjected Vetco to Subpart F of the Internal Revenue Code with respect to reporting VIAG's income. Vetco attempted to avoid this treatment by shipping its products to two Swiss corporations, which then transferred the goods to VIAG for sale. The IRS issued a summons for the production of documents located in Switzerland, which the Court of Appeals enforced.

United States v. *Whipple*, Cir. No. CR-81-36K (C.D.Ut. 1981). Whipple, a motion picture producer, was charged with tax fraud arising from his creation of a fraudulent movie tax shelter program which sold more than $4 million of fraudulent tax deductions and credits to the public. Proceeds were disbursed to a sham corporation in the *Cayman Islands* and a fictitious bank in the principality of *Andorra* which was used to provide the investors with phony leverage.

Zmuda v. *Commissioner*, 79 T.C. 714 (1982), *aff'd*, 731 F.2d 1417 (9th Cir. 1984). The Zmudas participated in a program developed by the American Law Association (see *United States* v. *Dahlstrom, supra*), for the avoidance of taxes on the income derived from properties in the United States. In accordance with the program, the Zmudas set up three foreign trusts in the *Turks and Caicos Islands*. The tax court found that the trusts were shams, disallowed certain deductions, and assessed civil penalties. The Court of Appeals affirmed.

III. THE USE OF OFFSHORE ENTITIES TO FACILITATE INVESTMENT OR OTHER FRAUD

Application of Chase Manhattan Bank, 297 F.2d 611 (2d Cir. 1962). A grand jury subpoena ordered the Chase Manhattan Bank to produce records located in its *Panamanian* branch. Upon showing that compliance by the branch would violate Panamanian law, the district court modified the subpoena leaving the next move up to the government but left the subpoena outstanding to insure the bank's compliance with its "duty of actively cooperating with the Government." Affirmed.

Arthur Anderson and Co. v. *Finesilver,* 546 F.2d 338 (10th Cir. 1976) *cert. denied,* 429 U.S. 1096 (1977). The State of Ohio brought an action against Arthur Anderson and Company alleging that the firm violated securities laws by misrepresenting the financial condition of a corporation which became bankrupt after the State had loaned it $8,000,000. The district court entered discovery orders which required the accounting firm to produce documents, even though production would violate *Swiss* non-disclosure laws. The appeal from the district court's order was dismissed for lack of appellate jurisdiction.

Bank Saderat (Iran) v. *Marashi,* (Super. Ct. Ca. 1982). Iradj Marashi, former manager of Bank Saderat's Los Angeles office, was charged with misappropriating $2.5 million in bank funds during the Iranian assets freeze. After convincing officials in Teheran that it was possible to circumvent the freeze by wiring funds for the Los Angeles office in personal drafts made out to him, Marashi transferred the funds to a private trust at Liechtensteinische Landesbank in Vaduz, *Liechtenstein.*

Brauch v. *Raiche,* 618 F.2d 843 (1st Cir. 1980). Brauch was arrested pursuant to provisional arrest procedures of an extradition treaty between the United States and the United Kingdom. Brauch filed a petition for habeas corpus which was denied by the district court. The Court of Appeals affirmed in part and reversed in part. The facts underlying the criminal acts alleged in the extradition request concerned in part: (1) a check for $300,000 drawn on insufficient funds at Brauch's *Bahamian* bank account; and (2) the fraudulent representation that several *Caymanian* bonds had been owned by a resident of the United Kingdom since 1972. Under the then current Exchange Control Act of England, the proceeds from the sale of the bonds, if owned by a resident of United Kingdom in 1972, would issue as "investment currency." As "investment currency" it would sell at a premium over the exchange rate for ordinary "restricted" currency. Brauch's net sum gain from these transactions was $2.5 million.

Bronston v. *United States,* 409 U.S. 352 (1973). Bronston was the sole owner of Samuel Bronston Productions, Inc., which produced motion pictures. Prior to declaring bankruptcy, Bronston transferred all assets to the 'company's' *Swiss* bank account. When asked if 'he' had a Swiss account, Bronston responded in the negative. Because his statement was literally true (the Swiss account was in his company's name), his perjury conviction was reversed.

Commodity Futures Trading Commission v. *Nahas,* 580 F. Supp. 245 (D.D.C. 1983), *rev'd* 738 F.2d 487 (D.C.Cir. 1984). A Federal regulatory agency investigating the 1980 silver crisis, served a subpoena on a Brazilian citizen in Brazil ordering his appearance in Washington, D.C. When he failed to appear, the district court held him in contempt and froze certain assets. The Brazilian government filed a formal protest with the State Department and 35 members of the Brazilian House strongly criticized the extraterritorial application of U.S. laws. The Court of Appeals, upon finding that U.S. jurisdiction did not exist, reversed.

Hughes Tool Co. v. *Meier,* 489 F. Supp. 354 (D.Ut. 1977). In a civil suit to recover for breach of trust and diversion of funds, defendants were held to have known of, and arranged the transfer of, nearly $5 million secreted in their *Netherlands Antilles* bank.

IIT v. *Cornfeld,* 462 F. Supp. 209 (S.D.N.Y. 1978). Plaintiff IIT was an "international investment trust" organized under the laws of *Luxembourg.* Its liquidators brought suit against 68 individual and corporate defendants alleging fraud against IIT's fundholders. The charges centered around three series of acquisitions by IIT of securities offered by a U.S. firm (King Resources, Inc.) and a *Netherland Antilles* subsidiary. IIT's principal, a *Canadian* corporation (previously *Bahamian*), which was owned in part by Robert Vesco, was also charged with fraud. The suit was dismissed for lack of jurisdiction. (See also *SEC* v. *Vesco, infra.)*

Index Fund, Inc. v. *Hagopian,* 417 F. Supp. 738 (S.D.N.Y. 1976). Hagopian, president of Index, was charged, along with his co-defendants, with violations of the Securities and Exchange Act. Hagopian allegedly caused Index to purchase worthless or inflated securities from the "Armstrong Fund", a Panamanian mutual fund. Defendants First National City Bank (FNCB) and First National City Trust Company (*Bahamas*) Limited (FNCT) filed cross claims alleging that co-defendants other than the Armstrong Fund were primarily responsible for the fraud. FNCB and FNCT then brought a third-party action against Messrs. Adams and Henry, directors of Index Fund, demanding indemnification or contribution for any liability that FNCB and FNCT might owe to the plaintiff. The third party defendants sought a motion to dismiss, which the court granted.

In re Arawak Trust Co. (Cayman), Ltd., 489 F. Supp. 162 (E.D.N.Y. 1980). A grand jury held an investigation to determine whether "kickbacks" paid to officials of the Central States Fund of the Teamsters Union were being laundered through Arawak, a *Cayman* corporation, as part of a scheme to defraud the Fund. When Arawak disobeyed a grand jury subpoena for the production of documents, a contempt order was sought. Held, a grand jury lacks the power to subpoena the records of a foreign corporation which maintains no office in the U.S., does not hold itself out as doing business within the U.S., and has no significant property within the U.S.

In re Sears, 425 F. Supp. 1190 (D.N.J. 1977). An action for the disbarment of Sears, attorney for Robert L. Vesco was commenced (See *SEC* v. *Vesco, infra.*). Allegedly, Vesco gave money to Sears through a *Bahamian* bank. Sears then made illegal political contributions in an effort to deter an investigation of Vesco's activities by the Securities and Exchange Commission.

Meason v. *Bank of Miami,* 652 F.2d 542 (5th Cir. 1981). Plaintiffs has purchased certificates of deposit issued by a *Cayman Islands* bank (Popular Bank and Trust Co. Ltd.) doing business through the Bank of Miami, both of which were wholly owned subsidiaries of a Florida chartered bank holding company. The plaintiffs filed suit alleging violation of Federal securities laws against all of the banks after failing to receive funds upon presentment and demand. The district court dismissed the suit for lack of subject matter jurisdiction. The 5th Circuit reversed and remanded, stating that further inquiry was needed to determine if the certificates were "securities" as defined by Federal securities laws.

New York County v. *Firestone,* (N.Y. Super. Ct. 1982). Promoters, Firestone and Dorison, were indicted for scheming to defraud over 200 investors of nearly $40 million in a fraudulent coal mining venture. To provide incentives for investment, defendants arranged loans of 3 times the amount invested from Columbus Trust Co., Nassau, *Bahamas,* to produce an inflated basis for tax deductions. Columbus Trust funneled $31 million through several offshore corporations disguising the transactions as loans. Firestone was convicted of conspiracy to defraud, grand larceny, and violations of general business law. He was sentenced to serve 2⅓ to 7 years concurrently and fined $2.5 million.

Quintel Corp. v. *Citibank, N.A.,* 567 F. Supp. 1357 (S.D.N.Y. 1983). Plaintiff, a *Netherlands Antilles* corporation, entered into an agreement with defendant-bank and others to purchase real estate in Florida. Plaintiff brought suit for fraud, negligence, and securities violations. Citibank sought a protective order alleging attorney-client privilege. Plaintiff and a third-party defendant then sought an order directing the bank's witness not to invoke the attorney-client privilege. The Court granted plaintiff's motion.

Schlensky v. *Dorsey,* 574 F.2d 131 (3d Cir. 1978). Shareholders of Gulf Oil Corp. sued to recover illegally expended corporate funds. In 1973 and 1975, Gulf officials revealed that the vice-president in charge of government relations, Claude C. Wild, Jr., had donated corporate funds to election campaigns. The allegations in plaintiffs complaint charged that over $10 million was channeled for eventual distribution to political individuals and entities in the United States and foreign countries, including $4,460,000 to the ruling parties in Korea and Bolivia between 1966 and 1977, through Bahamas Exploration Co., Ltd., a subsidiary of Gulf located in Nassau, *Bahamas.* The parties entered into a stipulation of settlement in the amount of $3,500,000 and the district court entered orders terminating the consolidated derivative suit. On appeal, the case was affirmed in part and vacated and remanded in part.

Securities and Exchange Commission v. *Minas de Artemisa, S.A.,* 150 F.2d 215 (9th Cir. 1945). The Securities and Exchange Commission sought a district court order enforcing a subpoena for the production of books and records of an Arizona corporation and its wholly owned subsidiary located in *Mexico.* The district court dismissed the application and the Commission appealed. On appeal, the subsidiary claimed that production of such records would be in contravention of Mexican regulations requiring that records remain in Mexico. The Court of Appeals held that if Mexican law would be violated, then some alternative form of compliance was in order. The dismissal was reversed and the proceedings remanded with directions to require enforcement of the subpoena in the manner indicated.

Securities and Exchange Commission v. *Banca Della Svizzera Italiana,* 92 F.R.D. 111 (S.D.N.Y. 1981). The SEC sought to compel disclosure by Barca Della Suizzera Italiana, a *Swiss* bank, of information about its customers suspected of purchasing, on insider information, call options immediately prior to a tender offer. The court required the bank to make disclosure, though Swiss criminal law prohibited the bank from doing so.

Securities and Exchange Commission v. *Bank of Credit and Commerce International, S.A.,* CCH Fed. Sec. L. Rep. § 96,355 (D.D.C. March 18, 1978). Defendant, a *Luxembourg* banking institution, was charged with violation of securities regulations. The bank, on behalf of clients, accumulated substantial ownership of Financial General Bankshares, Inc., a U.S. corporation, without complying with the beneficial ownership disclosure requirements of the Securities Exchange Act.

Securities and Exchange Commission v. *Banque de Paris et dis. Pays-Bas (Suisse) S.A.,* Civ. No. 77–0798 (D.D.C.). Defendant, a *Swiss* bank, was charged with Securities and Exchange Act anti-fraud violations for filing information statements which contained "untrue statements of material facts" in connection with acquisitions of securities of several U.S. corporations.

Securities and Exchange Commission v. *Cayman Islands Reinsurance Corporation, Ltd.,* 551 F. Supp. 1056 (S.D.N.Y. 1982), *Cayman Island* Reinsurance Corporation, and others were charged with securities fraud arising from one of the firm's underwritings. Co-defendants allegedly agreed to use $2.5 million raised from a $4.8 underwriting of CIRC to buy stock from other underwritings that had not been sold—a use of proceeds inconsistent with disclosures contained in the final prospectus. The SEC filed a motion to compel the testimony of one of the defendants over his assertion of the 5th Amendment. The motion was denied.

Securities and Exchange Commission v. *Certain Unknown Purchasers of the Common Stock or Call Options for the Common Stock of Sante Fe International Corp.,* 81 Civ. 6553 (WCC) (S.D.N.Y. 1981); *Securities and Exchange Commission* v. *Martin,* (W.D.Wash., 1981). Gary L. Martin was charged with trading in the securities of Santa Fe International Corp. based on "material non-public information" in violation of the Security Exchange Act. Illegal profits totaled over $1.1 million, at least half of which were secreted in Seattle First National Bank's Zurich, *Switzerland* branch. Also charged with fraudulent trading based on material non-public information were "certain unknown purchasers of the common stock of Santa Fe," trading through financial institutions.

Securities and Exchange Commission v. *Diplomat National Bank,* CCH 1977–78 Fed. Sec. L. Rep. § 96,180 (D.D.C. Sept. 28, 1977). Diplomat National Bank (DNB), a domestic bank, was charged with Federal securities violations in allowing several *Korean* nationals to purchase in excess of 5% of DNB stock without complying with beneficial ownership disclosure requirements. Purchases were concealed through the use of nominees. Diplomat consented to the entry of a final judgment order which permanently enjoined DNB from acts and practices in violation of Section 1761 of the 1933 Securities Act and Sections 10(b) and 10(b)(5) of the 1934 Securities Exchange Act. Other requirements were made of DNB including the filing of offering circulars with the Comptroller of Currency.

Securities and Exchange Commission v. *Drucker,* CCH Fed. Sec. L. Rep. § 99,529 (September 26, 1983). Through the use of aliases and *Swiss, Bahamian* and *Panamanian* corporate entities, defendant attempted to hide manipulative schemes in violation of Federal securities laws. For example, in 1975, Drucker and others attempted to sell 58,600 shares of unregistered stock in violation of Section 5(c) of the Securities Act. The sales were part of a scheme whereby Drucker, through his bank account at Castle Bank in the *Bahamas,* would acquire stock at a low or deflated price and then sell it to the public at an artificially inflated price.

Securities and Exchange Commission v. *Everest Management Corp.,* Civ. No. 71-4932 (S.D.N.Y 1979). Herbert, a former officer of a *Swiss* bank, was convicted for his participation in the manipulation of securities trading on U.S. over-the-counter markets and of repeated violations of anti-fraud provisions. He utilized *Swiss* bank secrecy laws to effectuate and then conceal the manipulative conduct.

Securities and Exchange Commission v. *General Refractories Co.,* 400 F. Supp. 1248 (D.D.C. 1975). General Refractories Co. (G.R.) and Mayer, a substantial shareholder of G.R., were charged with violations of the Securities and Exchange Act's antifraud provisions, including the failure to file required reports when acquiring a 5% interest or more in a public company. Mayer, an Austrian citizen residing in Switzerland, was found to be the beneficial owner of 17% of G.R., a Pennsylvania corporation, which he obtained through various *European* companies controlled by him. The court further found that the aggregate sum to be purchased was divided among the offshore corporations to conceal ownership. A preliminary injuction was issued by the District Court pending further proceedings.

Securities and Exchange Commission v. *Kasser,* 391 F. Supp. 1167 (D.N.J. 1975), *rev'd and rem'd,* 548 F.2d 109 (3d Cir. 1977). Kasser and several codefendants were charged with violating Federal securities provisions, by defrauding the Manitoba Development Fund, a Canadian government owned corporation. Kasser allegedly induced the fund to invest in debentures of two corporations owned by Kasser. The agreement provided that loan disbursements by the fund were conditional upon "matching" investments in Kasser's corporations. Rather than making such investments, however, Kasser recirculated the proceeds from the fund to make it look as if a Kasser-contribution had been made. The loan proceeds were laundered through various corporations and bank accounts in the United States, *Canada* and *Switzerland.* Although the district court dismissed the complaint for lack of jurisdiction, the Court of Appeals reversed, finding that instrumentalities of interstate commerce were used.

Securities and Exchange Commission v. *Katy Industries, Inc.,* Civ. No. 78C-3476 (N.D. Ill.). Katy Industries, a U.S. corporation, was charged with violating the foreign corrupt practices provisions of the Federal securities laws when it made a total of $250,000 in payments in connection with obtaining an Indonesian oil concession. Payments were allegedly funneled to an Indonesian government official through the official's *Cayman Island* corporation.

Securities and Exchange Commission v. *Musella,* 83-Ca-0342 (S.D.N.Y.). Dominic Musella was suspected of violating certain commodity trading laws through the use of a *Swiss* entity. The U.S. district court rejected Musella's claim of self-incrimination.

Securities and Exchange Commission v. *Vesco,* 548 F. Supp. 1270 (S.D.N.Y. 1981). Vesco, president and chief executive officer of International Controls Corporation (ICC), was charged, along with other corporate officers and directors, with the misappropriation of hundreds of millions of dollars from U.S. corporations that they directed and controlled. The court found that Vesco and his group engaged in a scheme to use ICC to obtain contol over the IOS complex, a Canadian holding company consisting of a complex of mutual funds and investment companies, and then to divert substantial assets from the IOS Funds into shell corporations located in *Panama,* the *Bahamas* and *Costa Rica.* Ultimately, the assets were to be transferred to accounts in *Bahamian* and *Luxembourg* banks which would be used for the personal benefit of the Vesco group. (See also *IIT* v. *Cornfield, supra.)*

Securities and Exchange Commission v. *Zolp,* Civ. No. 82-1384-K(I) (S.D.Cal. 1981). Evervac Corporation and Marshall A. Zolp, president of Evervac, were charged with fraud in the promotion of unregulated stock. The stock offering fraudulently claimed that Evervac had rights to a revolutionary fire escape product which it did not have. Funds derived from the scheme were secreted at Zolp's *Bahamian* bank account.

Societe Internationale Pour Participations Industrielles v. *Rogers,* 357 U.S. 197 (1958). Plaintiff, a *Swiss* company, sued to recover property seized by the U.S. pursuant to the Trading with the Enemy Act. The U.S. requested records of a *Swiss* banking firm which allegedly conspired with the plaintiff, but the Swiss government enjoined production of the documents. The district court dismissed the complaint. The Supreme Court reversed, holding that the fear of criminal prosecution excused noncompliance.

Southern Nevada Culinary and Bartenders Pension Trust Fund v. *American Casualty and Indemmity, Ltd.,* No. CU-LC-83-401 HEC (D. Nev., filed June 16, 1983); related matter: No. CV-LC-81-555 RDF (D. Nev., filed August 31, 1981). Trustees of the Southern Nevada Culinary and Bartenders Pension Trust Fund, after cancellation of their original policy of fiduciary insurance with Lloyd's of London, arranged to acquire fiduciary liability insurance through American Casualty of *Belize* (formerly British Honduras). Although American Casualty claimed investment reserves in excess of $20,000,000, when a former trust administrator filed a third party complaint against the acting trustees, American Casualty, which was in reality a sham corporation, failed to assume responsibility for their defense.

State v. *Williams,* Civ. No. C449099 (Super. Ct., Maricopa Co., Arizona, 1981). Williams and his wife were charged with engaging in a fraudulent tax shelter and various estate planning schemes by the use of five *Panamanian* corporations and two *Montserrat* banks, all of which they controlled.

United States v. *Becker,* 569 F.2d 951 (5th Cir. 1978). Becker and several codefendants were convicted of conspiracy to defraud. Defendants induced investments in ore through falsified assays and reports knowing the ore to be of little value and extraction unfeasible. Investors advanced approximately $500,000 to defendant's bank in the *Bahamas* on the pretense that the money was needed temporarily as a cash advance. Affirmed.

United States v. *Brinlee,* Cr. No. 3-81-181 (N.D. Tex. 1981). Brinlee and three co-conspirators were convicted for their participation in a scheme to induce individuals to cash fraudulent cashier's checks as payment for property rights. The fraudulent cashier's checks were written on the then defunct Agrindustrial Bank of Commerce located in St. John, *Antigua.* Brinlee, who pled guilty to two counts of conspiracy to commit mail and wire fraud and one count of mail fraud, received 5 year consecutive sentences on each count. Co-conspirator McPherson was convicted of wire fraud and sentenced to a term of 3 years. After the matter was remanded on appeal he received a 6 month sentence on his plea of guilty.

United States v. *Courtois,* (S.D.N.Y. 1982). Courtois and Adrian Antoniu, who were employed by two major New York investment banking firms, were charged with leaking confidential information on prospective acquisitions to outside traders. The traders allegedly purchased the stock in the target companies through secret bank accounts in *Bermuda, Bahamas, Luxembourg* and *Switzerland.*

United States v. *Cowley,* 720 F.2d 1037 (9th Cir. 1983). Victor Cowley and Michael St. Clair were subpoenaed to appear before a Federal grand jury investigating the Holland Oil Company. Cowley and St. Clair, who had cashed two cashier's checks in *Anguilla* for the Holland Oil company, were convicted of knowingly making false declarations before a grand jury. They appealed. Affirmed in part and reversed in part.

United States v. *Crawford Enterprises, Inc.,* Cr. No. H82-224 (S.D. Tex. 1982). Crawford Enterprises, Inc., was charged with making illegal payoffs to government officials in order to obtain purchase orders in a government contract. Defendant transferred funds in interstate commerce through certain unspecified foreign banks. Defendant's bid was inflated by 5% to cover the bribe. (The subcontractors were charged with aiding and abetting: See *United States* v. *Miller Corp.,* Cr. No. 82-788 (C.D.Cal.); *United States* v. *Ruston,* Cr. No. H-82-207 (S.D.Tex.); and *United States* v. *International Harvester Company,* Cr. No. H-82-244 (S.D. Tex., Houston Division).

United States v. *Crosby,* (D.Mass. 1982). Crosby and three others were charged with conspiring to acquire $23.1 million in real estate by the presentation of worthless cashier's checks issued by Financial Services Bank, Ltd., a *St. Vincent* bank, and by issuing financial statements reflecting fictitious transactions with the bank. The St. Vincent bank was controlled by the defendants.

United States v. *Dichne,* 612 F.2d 632 (2nd Cir. 1980), *cert. denied,* 445 U.S. 928 (1980). Dichne was convicted for his role in a scheme to avoid the filing of required currency transaction reports in violation of 31 U.S.C. § 5313 (Bank Secrecy Act). Dichne, a self-employed export-import and financial broker, had been contacted by Joseph Hauser, controller and operator of a number of insurance companies involved in providing health care insurance to labor unions, to transport to *Switzerland* $2 million embezzled from funds marked for workers' claims. Dichne deposited $400,000 (the first installment) in a Los Angeles bank. In return, Dichne received a cashier's check for $375,000, which he eventually presented for payment at a Swiss bank. Dichne's conviction was affirmed on appeal.

United States v. *Dickinson,* 706 F.2d 88 (2d Cir. 1983). John Dickinson, traveling under as many as three different aliases, successfully transported unreported money out of the country until his arrest in 1981. Carrying sums as large as $860,000 at a time, Dickinson was found in violation of the Currency and Foreign Transactions Reporting Act. He was also convicted on three counts of making false statements in a passport application. Initial investigations revealed that Dickinson had conducted transactions with *Hong Kong* and *Canadian* Banks and with an investment company in *Macao.* Dickinson appealed his conviction for failing to file a report of the transportation of currency. The Court of Appeals held that there was insufficient evidence to sustain the felony conviction but that "his conviction for the predicate misdemeanor violation . . . survives."

United States v. *Dioguardi,* 361 F. Supp. 954 (S.D.N.Y. 1973), *aff'd,* 492 F.2d 70 (2nd Cir. 1974), *cert. denied,* 419 U.S. 873 (1977). Defendants, John Dioguardi and Louis Ostrer, were convicted of securities fraud. The government's key witness, Hellerman, was involved with defendants in an elaborate scheme to manipulate the price of stock of a U.S. corporation in which he held a controlling interest. As part of the scheme, Hellerman laundered embezzled funds at a *Bahamian* casino (Paradise Island Casino).

United States v. *Doe,* 541 F. Supp. 1 (D.N.J. 1981), *aff'd,* 680 F.2d 327 (3rd Cir. 1982) *aff'd in part, rev'd in part and rem'd,* 104 S.Ct. 1237 (1984). During a Federal grand jury investigation of corruption in the awarding of county and municipal contracts, subpoenas were served on respondent-owner of sole proprietorships demanding production of certain business records, including cancelled checks and bank statements of two of respondent's companies which held accounts at a bank in the *Cayman Islands.* Respondent sought to quash the subpoenas and the district court granted the motion.

United States v. *Eimers,* Cr. No. 82-746-CR-SMA (S.D.Fla. 1982). Miami attorney Robert A. Eimers and several others were charged with operating an escort service as a front for prostitution, and laundering at least $500,000 of illegal profits through a *Bahamian* bank. The scheme was uncovered through Operation Greenback investigations, a joint project of the Internal Revenue Service and Customs Service concerned with investigating money-laundering activities in South Florida.

United States v. *Erwin,* (Super. Co., Riverside Co., Cal. 1982). Randolph Erwin, a former U.S. Life Savings and Loan Association employee, and Douglas Carlton, a Dallas businessman, were charged with defrauding U.S. Life Depositors of approximately $4 million. The funds were secreted at the Bank of Nova Scotia, *Cayman Islands.*

United States v. *Federbush,* 625 F.2d 246 (9th Cir. 1980). Defendant's were convicted of defrauding a U.S. corporation, Columbus Associates of Massachusetts. After acquiring the Windward Bank (Windward International Bank Limited) of Kingston, *St. Vincent,* defendant persuaded Columbus to transfer assets to Windward. The bank turned out to be a shell bank, neither licensed to do business nor possessing assets. Columbus was defrauded into paying obligations with the Windward checks which were totally worthless. Judgments affirmed.

United States v. *Feinman,* Cr. No. 80-257 (E.D.Pa., filed August 14, 1980). Feinman, and four of his associates, were convicted of defrauding six individuals out of more than $363,000 in fees for bogus construction bonds and financial guarantees backed by worthless bank certificates. The phony bonds and securities were marketed through Casualty and Indemnity Company, Ltd., formed under the laws of *Belize.* A false financial statement represented the corporation's assets to be $115 million. A fifth defendant, Seymour Pollack, was severed from the trial due to illness.

United States v. *Firestone Tire & Rubber Co.* 518 F. Supp. 1021 (N.D. Oh. 1981). Firestone was charged with violating the Gold Act, which prohibited unlicensed acquisition and holding of gold outside the U.S. by persons subject to U.S. jurisdiction. Bank Firestone, a *Swiss* bank and wholly owned subsidiary of Firestone, conducted certain transactions in gold, both lawful and common in Swiss banking. The government contended that the Swiss bank operated as an *alter ego* to generate profits for the American based company by engaging in illegal transactions. Held: since the subsidiary complied with Swiss law, Firestone could not be held liable.

United States v. *Friedland,* 660 F.2d 919 (3d Cir. 1981), *cert. denied,* 456 U.S. 989 (1982). The Friedlands were convicted of accepting kickbacks in their capacity as general counsel to the pension fund maintained by Teamsters Local 701 in New Jersey. Defendants arranged for Marlin, a California businessman, to receive a $3.5 million loan from the fund in return for a 9% kickback which defendants required be obtained from sources outside the U.S. banking system. For that purpose, Marlin used the First Kensington Bank of *Cayman Islands,* a bank under his control. Kickbacks were allegedly secreted at defendants' Swiss bank account at Banque L'Indochine et de Suez in Lousanne, *Switzerland,* under an alias. The convictions were affirmed on appeal.

United States v. *Funds Being Held in the Name of European Commodities, Ltd.,* (Civil Docket) (S.D.Tex. 1984). As a result of an investigation involving the Drug Enforcement Administration, FBI, IRS, Customs, and other Federal agencies, $6.8 million in accounts held at the Republic Bank of Houston in the name of *Cayman* companies, European Commodities, Ltd. and Continental Resources, Ltd., was seized—the largest single seizure of bank assets in the history of the United States.

United States v. *Jaeger,* Cr. No. 79-0054 (S.D.N.Y. 1979). Defendant was charged with wire and mail fraud for his participation in a currency exchange swindle involving the *Turks and Caicos Islands.*

United States v. *Johnpoll,* 739 F.2d 702 (2d Cir. 1984). Over a period of several months, Haney Johnpoll attempted to liquidate securities which were part of a $9.6 million theft from the vault of the Securities Settlement Corporation. In July 1980, one Kacendenbogan, acting on behalf of Johnpoll, induced Pfenniger, president of Gestofinance, a *Swiss* company, to resell the securities by claiming that they were owned by Italian planters attempting to avoid tax liability. At the request of Gestofinance, Merrill Lynch sold the securities valued at $400,000 and the proceeds were delivered to Johnpoll. For subsequent sales, Pfenniger's lawyer, Maas, set up a

Liechtenstein corporation ("Groclamore") which also opened an account at the Merrill Lynch in Geneva. Over the course of 2 weeks, transfers in excess of $4 million in stolen securities were made to Maas who deposited the securities in Groclamore's account at Merrill Lynch for sale. The proceeds from the sales were deposited in three *Swiss* accounts. Johnpoll was charged with the transport of stolen securities and the proceeds of those securities in violation of 18 U.S.C. §§ 2 and 2314 and was convicted in 1983. On appeal the conviction was affirmed in part and reversed in part.

United States v. *Kelly,* 569 F.2d 928 (5th Cir. 1978). Kelly, president of the Allied Fund For Capital Growth (AFCA), a *Panamanian* fund, was convicted for his participation in a scheme to defraud Harry Bloomfield, an investor in the fund. Kelly issued 200,000 shares of AFCA, restricted from redemption for 1 year, to one Ponsoldt. With Kelly's aid, Ponsoldt sold the shares to Bloomfield in return for shares in Bloomfield Building Industries, Inc., under the assurance that the 1 year restriction did not apply to third party purchasers. Bloomfield's subsequent attempt to redeem the stock was unsuccessful. The fund was in reality a sham, the shares of which were worthless. The conviction was affirmed.

United States v. *Kelly,* 349 F.2d 720 (2d Cir. 1965), *cert. deniea,* 384 U.S. 947 (1966). Cecil V. Hagen, Roy B. Kelly and Milton J. Shuck were convicted of a stock fraud conspiracy involving the sale of millions of dollars worth of unregistered common stock of Gulf Coast Leaseholds, Inc. (GCL) from late 1954 through 1956. Hagen and Kelly met with Van Allen, who purchased a large block of GCL stock through the Brandel Trust, a *Liechtenstein* trust that Van Allen represented. The agreement stipulated the purchase was for "investment purposes" and not resale, but Van Allen began selling huge quantities of stock immediately, as all three defendants schemed to stimulate public demand for the stock through GCL's grossly exaggerated reports. Hagen and Kelly allowed violations of the investment pledge in return for kickbacks paid by Van Allen from his secret *Swiss* trust to their secret trust. On appeal, the convictions of Hagen and Kelly were affirmed; Shuck's was reversed.

United States v. *Krown,* Cr. No. 80-CR-54 (Slip Opinion) (D.Col. September 5, 1980). Krown and several other co-conspirators were charged with transporting fraudulently made securities in interstate and foreign commerce—securities which were purportedly certified by the First National Bank of Teheran in *St. Vincent,* West Indies.

United States v. *Lemire,* 720 F.2d 1327 (D.C. Cir. 1983). Defendants were indicated and convicted of conspiracy to defraud Raytheon Company, a radar concern engaged in the installation of missile systems for the Saudi Arabian government, of $2.1 million. These funds were funneled through secret bank accounts of corporations in *Bermuda, Liberia, Liechtenstein,* and the *Cayman Islands.* Affirmed. (Also called the *Interconex* case.)

United States v. *McDonnell Douglas Corp.,* (D.D.C. 1979). McDonnell executives were convicted of bribing various officials of government owned airlines. The bribes were concealed through the use of purported "sales representation contracts" with offshore corporations in *Switzerland, Guernsey Islands, Bahamas, Bermuda* and *Belgium.*

United States v. *McPartlin,* 595 F.2d 1321, (7th Cir. 1979), *cert. denied,* in 444 U.S. 833 (1979). Defendants convictions resulted from their alleged bribery of Robert McPartlin, an Illinois Legislator, and other city officials of Stickney, Illinois, to secure a multi-million dollar sludge-hauling contract. Payments were made in both cash and letters of credit drawn on a *Swiss* bank account. In negotiating two of the letters, defendants directed a bank in Vaduz, *Liechtenstein* to present the letters to the Swiss bank. The convictions were affirmed on appeal.

United States v. *Murgo,* Cr. No. 82–67 (M.D. Fla., filed June 28, 1982). Murgo, head of Murgo and Sanborn Associates, Inc., was indicted in connection with a loan scheme involving *Caribbean* banks and *Canadian* money brokers. The advance fee scheme collected "preliminary approval expenses" for a loan which was never made. Murgo and seven of his associates were charged with mail fraud, interstate transportation of stolen property, and conspiracy. They were found guilty but in a post-trial motion the judge overturned the verdict. After further deliberation, the judge reversed his decision and reinstated the guilty verdict.

United States v. *Newman,* 644 F.2d 12 (2d Cir. 1981). Cortois and Adrian Antoniu, employees of a New York financial firm, allegedly misappropriated confidential information concerning proposed mergers and acquisitions entrusted to their employers by corporate clients. The information was conveyed to Newman, who passed along the information to two foreign nationals. The three used secret foreign banks and trust accounts in *Bermuda, Bahamas, Luxembourg* and *Switzerland* to purchase the stock, and spread their purchases among the brokers to avoid detection. The district court's dismissal of an indictment charging securities violations was reversed and the case was remanded by the Second Circuit.

United States v. *Payner,* 447 U.S. 727 (1980). Payner, who was charged with tax evasion, denied that he maintained a foreign bank account at the Castle Bank & Trust Co. of Nassau, *Bahamas.* Payner moved to suppress the introduction of a loan guarantee agreement which evidenced such funds as security. The district court found respondent guilty on the basis of all the evidence, but found that the government's search for the guarantee agreement was in violation of the Fourth Amendment and set aside the conviction. The Court of Appeals affirmed, but the Supreme Court held that respondent lacked standing to suppress the documents and reinstated the conviction.

United States v. *Phelps,* 733 F.2d 1464 (11th Cir. 1984). U.S. Customs Service agents, acting as purchasers in an undercover operation, exposed Phelp's and other co-conspirators' involvements in a escort service being used as a front for a prostitution ring. As part of the scheme, money derived from the illegal activity was moved outside the United States from where it could be returned for investment in legitimate business. The defendants were convicted for violation of the Mann Act and 31 USC § 5313, which requires the filing of currency transaction reports in connection with the transportation of U.S. currency.

United States v. *Rodriguez,* Cr. No. CR-82-673 (D.C.Ut. 1982). Rodriguez was charged with defrauding Felt, a Salt Lake City businessman, of $120,000. The sum represented prepaid interest for a loan Rodriguez purported to make to Felt for $1 million from the Agrindustrial Bank of Commerce, *Antigua,* of which Rodriguez claimed to be president. In reality, the bank was not licensed to do business in Antigua and had no funds.

United States v. *Sarault,* (D.R.I. 1982). Sarault, was charged with causing Barclay Douglas and Company, a prominent securities dealer, to credit his account with a $150,000 international treasurer's draft drawn on Societe Generale de Commerce (Overseas) Ltd., of Nassau, *Bahamas,* a bank not licensed for banking activities. When the check was returned as uncollectable, Sarault caused a second worthless check to be sent.

United States v. *Sindona,* 636 F.2d 792 (2nd Cir. 1980). Sindona, was convicted of a conspiracy to defraud American investors and the SEC in connection with the purchase of two U.S. corporations. Sindona misappropriated $15 million from the general accounts of two *Italian* banks he controlled and placed the funds on deposit at the Privat Kredit Bank and Amincor Bank in Zurich, *Switzerland.* The Swiss Banks then secretly transferred the funds to Sindona-owned corporations, which used them to acquire the corporations. Sindona filed false statements with the SEC, representing that the funds were his.

United States v. *Veliotis,* Cr. No. 83-0551 (S.D.N.Y., filed September 6, 1983). The indictment alleged that a $2.7 million bribe by officials of the Frigitemp Corporation was to be paid through companies in *Canada* and the *Caymans,* and through numbered bank accounts in *Switzerland* to high-level personnel of the General Dynamics Corporation in connection with its shipbuilding operations. One defendant was convicted in a 1984 trial, two are fugitives.

United States v. *Twombly, Inc.,* Cr. No. 80-73 (D.N.J. 1980). General Electic (G.E.) was awarded a contract with a power facility in *Puerto Rico.* According to the indictment, Twombly was to supply certain materials for G.E., which would then pay $4.2 million (including $1 million for the bribe fund) intended for Carlos Velaquez-Toro, Chief of Operations. The bribes were allegedly transferred from a New Jersey Bank to an account at *Bermuda* National Bank and then to Velasquez-Toro. Pursuant to a letter of request, an order authorizing the inspection of records pertaining to the bank accounts of Twombly, Inc., was issued. An indictment was returned March 13, 1980 for a violation of Title 18 U.S.C. §§ 1952 and 2.

United States v. *Wolfson,* 322 F. Supp, 798 (D.Del. 1971). Wolfson and several codefendants were convicted of participating in a scheme to defraud Agents General Insurance Company, Ltd., of Canada (AGI). Defendants induced various agents to purchase insurance through an offshore company located in Nassau, *Bahamas.* Defendants issued policies without reporting them and employed several other devices to defraud AGI. On motion for a new trial, the district court granted a judgment of acquittal on certain counts but denied the motion for a new trial.

United States v. *Wolfson,* 634 F.2d 1217 (9th Cir. 1980). Wolfson was convicted of defrauding the MGM Grand Hotel in Las Vegas, Nevada by cashing $115,000 in worthless cashier's checks at the hotel casino cashier's cage. Wolfson purchased the checks at a discount from Kevin Krown who owned the First London Bank and Trust Company of *St. Vincent,* West Indies, upon which the checks were drawn. The conviction was affirmed on appeal, but the sentence was vacated and the case remanded for resentencing.

APPENDIX 3

CHART: COMPARATIVE STATUTORY SECRECY PROVISIONS

Appendix 3 - COMPARATIVE STATUTORY SECRECY PROVISIONS[*]

Jurisdiction	Secrecy Laws	Criminal Sanctions for Violation of of Secrecy Laws	Civil Sanctions for Violation of Secrecy Laws	Requirement of an Annual Financial Report
Anguilla	yes	yes[1]	yes[2]	no
Antigua	yes	yes[3]	yes[4]	yes[5]
The Bahamas	yes	yes[6]	yes[7]	yes
Barbados	yes	no[8]	yes[9]	yes[10]
Bermuda	yes	no	yes[11]	yes[12]
The Cayman Islands	yes	yes[13]	yes[14]	yes
Hong Kong	yes	no	yes[15]	no[16]
Liechtenstein	yes	yes[17]	no	yes[18]
Luxembourg	yes	yes[19]	no	--
Montserrat	yes	yes	yes[20]	--
Nauru	yes	no	yes[21]	yes[22]
Netherland Antilles	yes	yes[23]	no	yes[24]
Northern Mariana	yes	yes[25]	yes[26]	yes[27]
Panama	yes	yes[28]	yes[29]	yes
Singapore	yes	yes[30]	yes[31]	no
St. Vincent	yes	no[32]	yes[33]	yes[34]
Switzerland	yes	yes[35]	yes[36]	yes
The Turks and Caicos	yes	yes[37]	yes[38]	no[39]
Vanuatu	yes	yes[40]	yes[41]	yes[42]

1. Confidential Relationships Ordinance, 1981. Chapt 10.

2. Tournier v. National Provincial and Union Bank of England,1 K.B. 461,C.A. (1924).

3. International Business Corporations Act, 1982, Sec. 244 (U.S. $18,850 and/or 1 year prison term).

4. Id at Sec. 236 (1) and 267.

5. Id at Sec 242 and 245.

6. Banks and Trust Companies Regualtion (Ammendment) Act, 1980, Sec 10. (U.S. $15,00 and/or 2 year prison term)

7. Id at note 2.

8. Fine of U.S. $2,000 and/or imprisonment of 12 months repealed by Sec. 11(b) of the Offshore Banking (Ammendment) Act, 1981-7.

9. Id at note 2.

10. Barbados Companies Law.

11. Id at note 2.

12. Companies Act No. 59, 1981, Sec 90.

13. The Banks and Trust Companies Regualtion (Ammendment) Law, 1979, Cayman Island Laws Chapt. 27; Confidential Relationships Preservation (Ammendment) Act, 1979, Cayman Island Laws, Chapt. 26, Sec. 4.
14. Id at note 2.
15. Id at note 2.

16. Companies Ordinance of Hong Kong, 1932, Sec 141 (D).

17. Bank and Savings Bank Law of December 21, 1960, Sec. 47 (b);(Note: if intentionally committed, F20,000 and/or imprisonment of 6 mos.; if negligently committed fine of F10,000 imposable).

18. Companies Law (as ammended in 1980).

19. Luxembourg Law on Credit Institutions of April 23, 1981, Art. 16. Fines by regualtion prescribed.
20. Id at note 2.
21. Nauru Legislation Corporation Act, 1972, Pt II, Sec. 12 (3); Nauru Trustee Corporation Act, 1972, Sec 33.

22. Nauru Legislation Corporation Act, 1972, Pt V, Div 5, Sec 133 (2) and (5); (Note: returns are not available for inspection)

23. Wetboek von strafrecht voor de Kolonie Curacao (now extended to the Netherlands Antilles), 1936, Art. 285 to 287; (Note: 6 mos. and/or 600 Guilders fine).

24. Bank van de Nederlands Antillen (voorheen de Curacaosche Bank), Sept. 25, 1961, Official Gazette No. 158, Chapt. V, Sec. 36.

25. Commonwealth Banking Code of 1983, Chapt. VIII, Sec. 803 (b) and (c); Chap. 10, Sec 1012 (b); (Note: one year or by a fine not in excess of U.S. 5,000).

26. Ibid at Chapt. VIII , Sec. 1014; Injunction is permitted.

27. Ibid at Chapt. VIII, Sec 801 (e), 802, 803(a) and 805.

28. Criminal Code of Panama, Law No. 6 of November 17, 1922, Gaceta Oficial, December 8, 1922, Art. 148.

29. See generally Panamainian Civil Code; Commercial Code of Panama (Ammended), Gaceta Oficial, June 4, 1917, Art. 88, 89, 112, and 639.

30. Singapore Banking Act, 1970, Sec. 42(2); (Note: 3 years imprisonment and/or $10,000 Singapore Dollars).

31. Id at note 2.

32. C.f. St. Vincent International Companies Act, 1982, Sec 7(1)

33. Id at note 2.

34. International Companies Act, 1982, Sec. 5(9) and 8(1).

35. Swiss Bankers Code, 1933, Art. 48.

36. Swiss Civil Code, Art. 27 and 28; Code des Obligations, Art. 398.

37. Ordinance to Give Sanction to the Duty of Non-Divulgence of Information, Nov. 3, 1979 (Note: up to U.S. 10,000 and/or 3 years imprisonment); Companies Ordinance, 1981, Sec 199 and 204.

38. Id at note 2.

39. Companies Ordinance , 1981, Sec 187; But see: Banking Ordinance of 1979 relating to Class B Banks.

40. Companies Regualtion Act of Vanuatu (New Hebrides), 1971, Part X Sec. 416 and 430; Companies Law, 1971, Art. 163-5.

41. Id at note 2.

42. Companies Regulation Act, 1971.

* Note: this chart does not attempt to indicate the relative strengths of secrecy laws or denote which jusrisdictions promote secrect by such devices as numbered bank accounts, bearer shares, or the use of nominees.